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The Treatment of Efficiencies in Merger Review: An International Comparison

Submitted by:

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University of British Columbia and Delta Economics Group Inc.

Date: November 22, 2002

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1 Statement of Purpose and Introduction

1.1 Purpose

This study has been prepared at the request of the Government of Canada in order to inform discussions related to the proper consideration of efficiencies in merger review in Canada. The immediate purpose of the report is to review and contrast the approaches taken by competition agencies and courts in a number of jurisdictions with respect to the principles and methods they apply in reviewing mergers that promise significant efficiencies at the same time as they threaten -- to at least some degree -- competition.

The study will focus on four jurisdictions: Australia, the European Union, the United Kingdom and the United States. These represent potentially important examples for Canada as they are all significant jurisdictions with modern economies (like Canada's) as well as sophisticated antitrust laws with skilled, professional enforcement agencies. The experience of these authorities will no doubt be relevant for the design of a Canadian approach.

1.2 Introduction

Mergers and acquisitions have become an important fact of the economic lives of modern market-based economies. Even if weaker growth has slowed the pace of M&A activity somewhat in the last few years, there is no denying that dynamic economies demand the kind of structural innovation often accomplished through the reallocation of assets and skilled workers in a merger. Under the right conditions, mergers can deliver a wide variety of benefits to customers, shareholders, employees and suppliers. These benefits include most obviously products produced at lower costs, products of higher quality and the creation of new products. Less obviously, mergers can contribute to stability of employment, to the retention and better application of scarce worker skills and to the better management of supply chains.

However, even as they promise benefits, mergers can pose certain risks for the aforementioned groups. Famously, many mergers have proven to be disasters for the firms involved. Indeed

there is a growing empirical literature in economics showing that a significant fraction of mergers may not yield the benefits the merging firms expected.[1] While losses in these cases fall to those responsible for the transaction (and who stood to benefit if it was successful) other negative effects of mergers can fall on outsiders, principally customers and competitors. Mergers can contribute to the creation of market power, leading to higher prices for customers. Mergers can also help to build dominant firms, which may take advantage of their market strength to disadvantage smaller rivals through various means. They may, for example, choose to employ predatory techniques to eliminate small rivals, or they may insist that suppliers not sell to those rivals.

It is the concern with these external effects that has led many countries to enact merger review provisions as part of their antitrust arsenal. Indeed, merger review has become one of the three main elements of a modern competition law, together with rules on price-fixing and abuse of a dominant position. The challenge for public policy toward mergers is to craft a law, and design enforcement, that allows mergers that promise substantial social benefits to proceed while blocking (or restructuring) those that do more harm than good. Two difficult questions must be addressed: (i) which effects of mergers are to be viewed as good and which as bad; and (ii) what rules are to be used to evaluate a merger when there are both good and bad effects?

1.2.1 Motives for Mergers

The motives for mergers are many and varied, but most can be placed into one of two broad categories used by antitrust experts. First, mergers may be motivated by a desire to achieve certain efficiencies that will make the merged entity "better" than the original participants. It could be, for example, that the merger makes possible longer production runs, better use of scarce management skills or the sharing of important intellectual property. The result could be old products produced at lower cost or new and better products. Second, a merger may represent an attempt by the parties to reduce competitive pressure, creating market power and likely leading to higher prices. Of course, many mergers will be motivated by a desire to achieve both of these benefits for shareholders – lower costs and higher prices. While the lower costs can be

[1] See, for example, Mueller (1980) and the discussion in Röller et al (2000), pp. 36-42.

viewed as society's gain (fewer resources used up) the higher prices hurt consumers. The various effects of such a merger can be illustrated with a diagram such as that in Figure 1.[2] In this diagram the line D represents the demand for some product by consumers. Initially – pre-merger – this product is produced and sold at price P1 which, thanks to vigorous competition by the two sellers, equaled the unit (or average) cost (AC1). The merger of the two firms produces market power, which is demonstrated by the fact that the price rises to P2, but at the same time it produces significant efficiencies that push the average costs down to the level AC2. The higher price leads consumers to buy fewer units – the number of units sold falls from Q1 to Q2. To analyze the impact of the merger on consumers and shareholders we need to measure how these price and quantity changes effect their welfare in this market. This we do using the economists' concepts of "consumers' surplus" and "producers' surplus".

Consumers' surplus refers to the difference between what consumers have to pay for a particular quantity of a good and the maximum they would have been willing to pay for that quantity. On a graph like that in Figure 1, this is illustrated by the area beneath the demand curve (which gives the value consumers place on each successive unit) and above the price they are paying. Before the merger, consumers were enjoying surplus equal to the combined areas A+B+C but due to the higher price post-merger, their surplus falls to that equal to area A. The firms' surplus can be represented here by their profits or the difference between the revenues they collect and the costs they pay. The profit per unit then will be the difference between the price and unit or average cost. Profits before the merger were zero as P1=AC1. [3] After the merger, profits per unit rise to

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[2] This type of diagram was made famous by Oliver Williamson (1968) in his discussion of efficiencies in merger review. We use it here as an expositional device, not as a precise method for the evaluation of the effects of the merger. Williamson himself recognized the analysis can be complicated by such considerations as pre-existing market power and firms outside the merger who may or may not achieve any efficiencies.

[3] We are referring here to "economic profits" – an economists' term referring to profits over and above a normal rate of return (taking into account the level of risk). Thus, a firm making zero economic profits is doing as well as we would expect a competitive firm to do and has no reason to exit the market – it is covering all its costs and making a normal rate of return on invested capital. Implicit here is the idea that "costs" as defined by economists include the full opportunity cost of all resources used in production – thus, the costs in the diagram above include an allowance for the normal return to invested capital.

the difference between the new price (P2) and the new average cost (AC2). Total profits now are then illustrated by areas B+E.

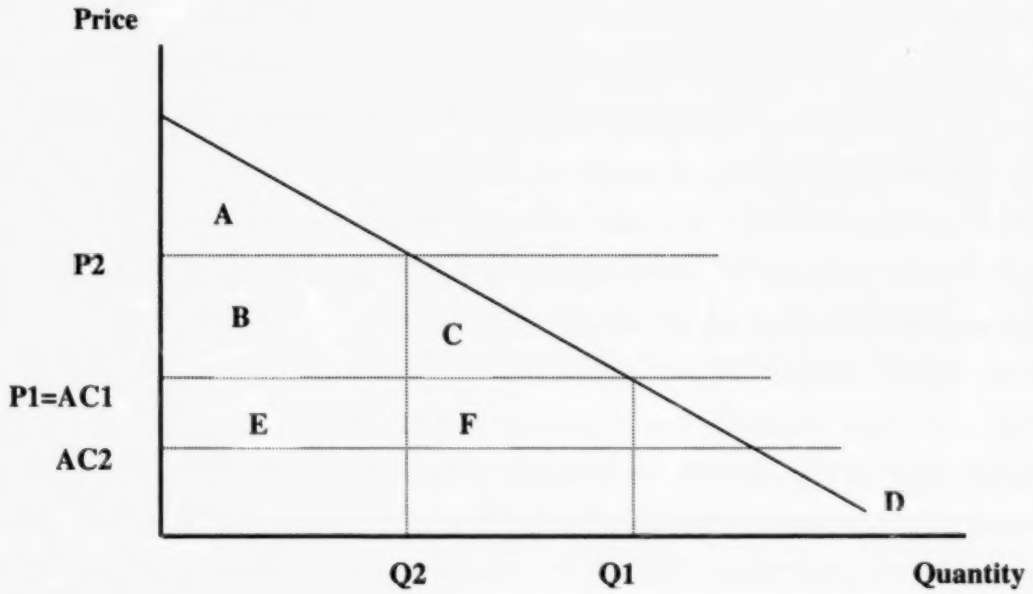

Figure 1

Notice that area B, which was lost by consumers, is gained by the firms – that it, it represents a transfer of surplus from buyers to sellers. Area C is consumers' surplus lost by consumers and not transferred to firms – this is referred to as "deadweight loss" by economists and it represents surplus lost to society because the firms produce less output. The area E, on the other hand, represents new surplus created by the more efficient production of the merged firm.

We can therefore see that the merger has three main effects here: the restriction of output has created deadweight loss (area C); the higher price has transferred surplus from consumers to producers on the units still sold (area B); and the efficiencies have lowered the costs of producing this output (area E). There is a general consensus among antitrust scholars that the

creation of deadweight loss is a bad thing for society and that efficiencies are a good thing. Views on the social impact of transfers are less homogeneous and this is reflected, in part, in the various approaches we study below.

1.2.2 Changing views of efficiencies

As this report is being written, many countries are struggling with the questions of, not only how to measure these effects, but also of how to weigh them. Tellingly, all the jurisdictions reviewed in this study are considering changes to their approach to evaluating efficiencies in merger cases, or have recently announced changes:

(i) In Australia, the 1999 Merger Guidelines described more completely how efficiencies will be considered in merger review and there are calls now for further revisions to the law to make it more sympathetic to efficiency claims. [4]

(ii) In the European Union, pressure has been mounting for the Commission to consider efficiencies more positively after concerns arose in a number of cases that efficiencies were insufficiently appreciated. This concern rose again recently with the Commission's rejection of the GE-Honeywell merger. The Commission decided, in June 2000, to begin a major review of the Merger Regulation and in December 2001 a Green Paper outlining possible reforms was released. The Green Paper invited views as to how efficiencies could be incorporated without suggesting an approach itself. Commissioner Monti has said that he personally favours creating an efficiency defense.[5]

(iii) In the United Kingdom, the government has produced a White Paper (2001) outlining possible changes in the competition law of the UK, in part to bring it closer to the model used for the EU. In anticipation of the forthcoming changes, there has recently been a marked reduction in the degree to which there is political involvement in antitrust decision-making.

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[4] See, e.g. Williams and Woodbridge (forthcoming).

[5] Monti (2002), p. 5.

(iv) In the United States there continues to be an evolution in the way the enforcement agencies and courts treat efficiencies in mergers. In 1997 the joint FTC-DOJ Merger Guidelines were revised to provide a more detailed treatment of efficiencies and enforcement officials continue to speak publicly about how much respect efficiencies now receive in merger review.[6]

1.2.3 The Role of Efficiencies and the Goals of Antitrust

It would be fair to say that something of consensus has been developing as to some of the appropriate goals of competition policy. Typically now, competition policy is seen as a tool for protecting and enhancing the competitiveness of markets, not simply for the sake of competition, but because competition generates certain benefits that are valued.[7] Most significantly perhaps, economists believe that competition contributes to an efficient allocation of resources, facilitating the creation of wealth and raising living standards. Competition can have other valued consequences, not necessarily unrelated to efficiency, such as providing low prices and broad product selection to consumers, protecting smaller businesses from abuses by larger firms and facilitating the economic integration of distinct geographic areas.

It is important to recognize that competition and efficiency are not one and the same thing, that mergers can have independent effects on both, and that these effects can be positive or negative in each case. Consider first the possible effects of mergers on competition. To begin we need some way to measure competition – i.e. what does it mean to have more competition or less? Competition could be measured by the number of competitors, or their size distribution or by some qualitative assessment of the vigorousness of their rivalry. However, the most common

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[6] In his introduction to a special section of Antitrust devoted to a discussion of the 1997 revisions to the U.S. merger guidelines, Weiner (1997) says: "One trend in antitrust decisionmaking does seem clear: rigidity in the form of per se rules and market share presumptions is being abandoned in favor of a broader analysis and balancing of anticompetitive effects and procompetitive efficiencies."

[7] There is not a consensus that this is the only goal of competition policy and we do not wish to suggest there is. There is disagreement about whether competition policy should be used, for example, to protect consumers from higher prices and to protect small business in its competition with big business.

approach among economists is to assess the competitiveness of a market by how closely the market price approaches the competitive price – where the latter is taken to be the long run marginal cost of the good in question. This can be measured, for example, using the Lerner index -- the percentage deviation of price from marginal cost.[8] Though competition is a process, it is measured here by its effect on price: mergers that reduce competition would reveal this through post-merger increases in the value of the Lerner Index.

Measured this way, mergers can increase or decrease competition in a market. If a merger combines two small firms, allowing them to realize significant efficiencies through economies of scale, it could well lead to lower prices (and a lower Lerner Index) by turning them into a much more powerful competitor for the established larger firms. On the other hand, if the merger reduces the number of vigorous competitors or eliminates a particularly effective competitor, it could certainly reduce the competitiveness of the market.

To stress an important point, mergers can generate efficiencies and affect competition. Their effects on competition can be direct, for example by reducing the number of vigorous competitors, or can work indirectly through efficiencies as when more efficient firms become stronger competitors. The result of this is that we should recognize that, with respect to efficiencies and competition, a merger will produce one of four outcomes:[9]

(i) there will be efficiency gains and an increase in competition;

(ii) there will be efficiency losses and a reduction in competition;

(iii) there will be efficiency gains but a reduction in competition; or

(iv) there will be efficiency losses and an increase in competition.

If we anticipate category (i) there is little reason for antitrust intervention, and if a result like (iv) is anticipated, the merger will not be proposed by the parties. This leaves the antitrust authorities with cases (ii) and (iii). Case (ii) mergers will only come forward if the lessening of competition

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[8] To be precise, the Lerner index is given by L, where L = (price – marginal cost)/ price. In a perfectly competitive market L=0 since price will equal marginal cost. In a monopoly market it can be shown that L = 1/e where e is the market elasticity of demand.

[9] Of course, there is also the possibility that there is no effect on efficiency and/or on competition.

is sufficient to compensate the firm for the higher costs, but they would not fare well in the review process of any of the countries studied here.[10] To approve such a merger requires that the authorities give greater weight to the interests of the merging parties than to those of consumers. Therefore, in these countries, the difficult cases are those in category (iii), those that lower costs but reduce competition.

1.2.4 Types of Efficiencies [11]

With respect to efficiencies that represent real savings of resources, there are, broadly speaking four kinds of efficiencies that arise in the consideration of mergers; (i) productive efficiency; (ii) allocative efficiency; (iii) dynamic efficiency; and (iv) transactional efficiency.[12] What these various types of efficiencies have in common is that they allocate scarce resources to generate wealth. In addition, it is possible that the merger will generate pecuniary efficiencies – these are simply transfers from other agents in the economy rather than real resource savings. While these are less relevant in antitrust merger analysis, they may not be completely irrelevant and will be considered briefly in a later section below as well.

Productive efficiency refers to ability of firms to get the most output from the least input given the current technological constraints. Mergers can enhance productive efficiency in a number of ways. We give here three generic examples. First, the merged firm maybe benefit from economies of scale through longer production runs or the sharing of fixed assets. Second, the merging firms may have complementary specialties, the combination of which provide synergies allowing the new firm to produce higher quality and/or at a lower cost.[13] Third, the merging firms may be complementary with respect to outputs in the sense that the merged firm will enjoy

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[10] Such a case could arise if the only two firms in a market combined simply for market power reasons. The costs of effecting the merger and the possible X-inefficiencies that would arise post-merger could make the combined firm less efficient.

[11] There is a nice discussion of these types of efficiencies in Kolasky and Dick (2002).

[12] Transaction efficiency is not always listed as a distinct type of efficiency, however, following Kolasky and Dick (2002) we find it useful to give them their own category.

[13] For example, one firm may have a very successful human resource management program and the other may be better at production.

economies of scope, which arise when it is less costly to provide a set of products than to provide the products individually. Mergers that allow firms to offer more complete product lines and so to economize on marketing and distribution costs would create these kinds of benefits.

While much less talked about, it can also be the case that mergers actually harm productive efficiency. Most obviously this can arise if the merger never "works" in the sense that the two organizations are not successfully integrated, for example production and human resource problems are never sorted out.[14] However, inefficiencies can also result from a merger that creates market power that shields the merged firm from the competitive pressure to keep costs down. We are referring here to what economists call "X-inefficiency" – roughly, the inefficiencies that arise when firms with market power get lazy with respect to cost control. Without being pushed by competition to keep them down, costs may creep up over time.[15]

Roughly speaking, allocative efficiency is achieved when firms produce any units for which consumers are willing to pay the marginal cost of production (i.e. firms produce the "optimal" quantity) and when whatever quantity is produced is allocated to the highest value buyers. Mergers can improve or impair the achievement of allocative efficiency. The greater concern is that they will damage allocative efficiency by creating market power, permitting firms to raise price by reducing the quantity produced below the optimal level. If the merger gives firms the ability to discriminate in price between different classes of buyer there can be the further problem that whatever quantity is produced is not allocated to the highest valued users.[16]

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[14] Röller et al. (2001), chapter 4, have a very nice review of the empirical literature on the success of mergers.

[15] The concept of X-inefficiency is due to Liebenstein (1966). See also the brief discussion and references cited in Church and Ware (2000, pp. 145-147). It is somewhat controversial with some economists arguing that all firms have trouble controlling costs and even firms with market power have an incentive to control them as best they can – they will have higher profits if they are successful.

[16] In such a case, the firm will allocate output to the users that contribute the greatest additional revenue (i.e. marginal revenue) but these are not necessarily those who value it most highly (who are the ones willing to pay the highest price).

Some mergers may have more positive implications for allocative efficiency. We are thinking here specifically of vertical mergers (i.e. mergers of firms connected in the vertical distribution chain) and mergers of firms that produce complementary products. In the classic case of successive monopoly, a monopoly manufacturer sells its product to local monopoly retailers. If the manufacturer is to maximize its profits it will charge a price above its marginal cost, but profit-maximizing retailers will take this wholesale price and mark it up further. The resulting double mark-up will in many cases lead prices to be higher – and quantities lower – than if the manufacturer was to own the retailers and set their prices. Not only will retail prices be lower, but the total profits earned will generally be higher, so both consumers and producers win. The removal of the second mark-up through the merger will then improve allocative efficiency.

The achievement of dynamic efficiency requires that sufficient resources be devoted, and efficiently employed, to support innovation leading to lower costs and new/better products. With increased recognition of the importance of dynamic efficiencies merger analysis has become even more complicated, requiring us to predict a merger's impact not only on markets in the short term, but also well into the future.

As with the previous cases, mergers can improve or retard dynamic efficiencies. A merger of two firms with sub-efficient research and development groups might allow the R&D groups to benefit from economies of scale and become more successful. However, if mergers reduce the vigor with which firms undertake risky and costly research programs, the result could be less total research done and eventually a slower rate of technical progress in the market.

Finally, transactional efficiency recognizes that firms and consumers expend resources in an effort to define and protect property rights and that some forms of organization might mitigate the costs necessary to do this. For example, a firm with a promising new product may need additional services (e.g. marketing, distribution) to bring it to market successfully. It may seek these services from specialist "partners". However, in a world in which it is very difficult to protect and enforce intellectual property rights, the firm risks losing profits to former partners who may copy its ideas for themselves after they have been revealed in the course of the partnership. As a result, the innovating firm may undertake less innovative activity or it may

spend inordinate sums protecting its secrets. Or it may not tell its partners all it should.[17] A merger between the partners in this case, could create efficiencies by keeping all these services "in-house", reducing concerns about this kind of "opportunistic behaviour". As Coase (1937) recognized so many years ago, there is a cost for firms in using the market to obtain services and products they need, and there are also costs to firms associated with providing those for themselves. In general we would expect that a firm will expand into doing more and more for itself until the cost of organizing additional transactions within the firm are equal to the cost of using the market for the same transaction.

A transaction cost analysis can therefore help us understand why firms might choose not to rely exclusively on other firms through arms-length market-mediated exchange, but might instead prefer to protect themselves through more integrative arrangements such as strategic alliances or even mergers.

1.2.5 Incorporating Efficiencies Into Merger Analysis

Recognizing that efficiency effects can be associated with mergers then raises the important policy question of how efficiencies should be incorporated into the review of mergers by an antitrust agency. With respect to combining evidence of efficiencies with that of possibly increased market power, we suggest that there are at least six alternative approaches, each of which has been applied (to some extent) in one or more jurisdictions at some point in time. Roughly, they range from ignoring the efficiencies completely to giving them the same weight attached to every other effect of the merger. In the discussion that follows (apart from point 1) we will assume that the efficiencies have been properly measured and that the antitrust authority can be convinced of their magnitude.[18]

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[17] See, e.g., Williamson (1989).

[18] Most enforcement agencies (see the discussions in later chapters) will require that the efficiencies be supported by credible evidence that they represent real resource savings (and not just transfers from some agents to others), that they do not simply represent savings from reduced production, that they are very likely to be achieved and that they cannot (or would likely not) be achieved by less anticompetitive means. For the purposes of this discussion we assume these conditions have been met, or could be met.

1. **Ignore them:** While accepting that most mergers are motivated by the desire to achieve certain efficiencies, it may still be that in some jurisdictions it is decided that the evaluation of efficiencies on a case by case basis is simply too difficult. It may then be determined that if a merger is expected to lessen competition it should be prohibited with no consideration of efficiencies. This *per se* approach to merger review is reminiscent of the *per se* rules for certain kinds of horizontal agreements found in, for example, the United States. It may be a bit extreme to suggest that this type of approach characterized the American model in the early years of the Cellar-Kefauver Act (1950), but it is true that American courts of that period were quite hostile to efficiency arguments.[19]
2. **Efficiencies as motive:** Antitrust regulators care about what the actual effects of a merger will be, but this they must try to predict with the imperfect information available to them. One important piece of information they would love to have is what the merging parties truly expected would be the effects of the merger. Of course, both sides recognize that merging firms hoping to create market power will not want to admit as much, so asking the firms directly is not very helpful. However, if the firms can persuasively demonstrate that real efficiencies will exist, this would constitute credible evidence that efficiency was the motive. Of course, this does not preclude market power effects as well, but it is progress. Perhaps the most telling case is when the merging firms cannot demonstrate that there will be efficiencies – this leaves market power as the leading alternative explanation.[20] Notice that under this approach the efficiencies are not applied as a defense or any counterweight to a lessening of competition – they are simply used as evidence that the merging firms did not expect there to be any such lessening. While we cannot say we know of any jurisdiction that uses this approach exclusively, we suspect the idea of using efficiencies when inferring motive is commonly applied.
3. **Adjust the structural thresholds:** A more sensible version of the first approach (ignore) was put forward by scholars associated with the Chicago school of antitrust.[21] This approach

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[19] See, e.g., Brown Shoe v. U.S., 370 U.S. 294 (1962); U.S. v. Philadelphia National Bank, 374 U.S. 321 (1963); and FTC v. Procter & Gamble Co., 386 U.S. 568 (1967).

[20] Of course, there will be other possible explanations such as empire-building, so this is not necessarily the end of the investigation.

[21] See, e.g. Posner (2001) and Bork (1978).

agreed that efficiencies were an important consequence of most mergers but argued that they were very difficult to properly assess. The solution proposed was simply to set the structural thresholds higher before mergers were to be challenged but to otherwise not consider efficiencies on a case-by-case basis.

4. **Efficiencies as part of the lessening of competition test:** A third approach blends the consideration of efficiencies with that of the lessening of competition. If a country's law provides for action against mergers that lessen competition "substantially" (or some other such modifier) the door is opened to consider whether efficiencies render any particular lessening insubstantial.[22] Thus, a merger that reduces competition but generates significant efficiencies might be saved under this approach by arguing that, thanks to the efficiencies, the lessening is not substantial. Pushing this still further, it has been suggested that we can even redefine the word "competition" to incorporate efficiencies without needed to use any modifier. While many economists (including the authors) associate "competition" with an absence of market power and therefore think about measuring it with something like a Lerner Index, other antitrust commentators have treated competition as more directly related to price levels. Under such a definition, a market is more competitive after a merger if price is lower, even if the merger has created a monopoly. It might be said that this is the path the United States has taken more recently, and it is approach that Röller et al (2000) have suggested might work (without changing the Merger Regulation) for the EU, if that Commission wanted to give efficiencies greater respect.
5. **Efficiencies as part of a dominance test:** When the concern of the agency is with the creation or extension of a dominant position, efficiencies for a merging and dominant firm, can be viewed as a bad thing. This was the case in some of the early U.S. cases (e.g. Procter & Gamble) and in numerous EU cases. Of course, as with lessening of competition tests as just described, efficiencies can be incorporated positively by blending their consideration into the evaluation of the merger's effect on dominance. For example, a merger creating a firm with a very large market share might be permitted, not because the firm will not have

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[22] On the possible definitions of "competition" and how they relate to merger review in the U.S., see, e.g. Werden (1997).

significant market power, but because it secured that position through the achievement of significant efficiencies. [23]

6. **An efficiency defense:** In this model, mergers that have been found to lessen competition can be defended by arguing that the efficiencies created outweigh (in some sense) the costs of the reduced competition. Canada's efficiency defense in section 96 of the *Competition Act*, certainly falls into this category.[24]

Comparing these six approaches, it is clear that the last is the one with the greatest scope for introducing efficiency arguments. However, the model as presented here does not tell us how we weigh anticompetitive effects against efficiencies. There are many possibilities here, and this is the topic to which we turn shortly.

First, however, we want to point out that there is another way in which efficiency considerations can be introduced into the review of mergers, and that is as an element to be considered as part of a **Public Interest (or Public Benefits) Test.** Under such as test, as applied in the U.K. and in Australia (for authorizations), various aspects of the public interest can be brought to bear on a decision regarding the social suitability of a merger. Public interest may be defined quite broadly, and has included such elements as employment effects and regional distributions of income.[25] When the public interest test is dominated by efficiency considerations, it can come to

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[23] This discussion assumes that the dominance referred to represents a strong position by a single firm. It is interesting to consider, however, the implications were the antitrust authority and courts to consider "joint dominance" cases in which a group of firms together hold a dominant position. If the firms determined to be jointly dominant are not explicitly cooperating (or colluding) with each other, this approach could look very similar to the approach under which efficiencies are considered as part of a lessening of competition test.

[24] As described briefly below, this may also, in effect, be what is happening in some jurisdictions (e.g. Australia) with public effects/benefits tests. Griffin and Sharp (1996) p. 657 express the view that U.S. cases have oscillated between considering efficiencies as part of an SLC test (category 4 above) and as a defense (category 6).

[25] These are examples from the U.K.. The reference to the Australian example here is to the conditions for securing an authorization for a merger – that is where the public benefits test applies. Outside of the authorization process, the model used for the consideration of efficiencies is more like the third approach described above – evidence of efficiencies can be used to argue that there will not be a substantial lessening of competition. There is not much guidance available as to what might constitute public benefits in Australia other than efficiencies.

look rather like an efficiency defense (approach 6 above), but clearly this is not the only way it can work. In other cases efficiencies can be thrown into the "public interest soup" out of which decisions are served and it can be difficult to determine how important efficiencies actually are.

1.2.6 What Efficiencies Count?

Regardless of how they choose to use efficiencies (unless they choose to ignore them completely), enforcement agencies must decide what efficiencies will "count" as they evaluate the merger. In a system in which efficiencies are only relevant to the extent they contribute to the market power of a dominant firm, presumably any efficiency that contributes to the ability of the dominant firm to compete against its smaller rivals would be considered.

The situation is more complicated when efficiencies are seen as a positive factor to be considered against the possible anticompetitive effects of a merger. The agency may not want to give the merging firms credit for every dollar of cost reductions they achieve. And the agencies (and perhaps the courts) will have to decide what level of certainty is required before efficiency claims are accepted. To be specific, the agency must consider the following questions:[26]

(i) To what extent should the efficiencies be merger specific – that is, must the parties demonstrate that the efficiencies will not be realized absent the merger?[27] In general antitrust agencies want to credit the merging parties with efficiencies that would not have been realized otherwise, but the degree of certainty they require about the counterfactual (what happens absent the merger) may vary. They may credit the merger with the efficiencies unless they are "very likely" to be achieved anyway, or

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[26] One question not listed here asks which party, the government or merging firms, has the responsibility of putting forward the efficiency arguments. This is not a very interesting question, however, because it is hard to imagine this burden not being put on the merging parties since they are the ones with the necessary data. They obviously also have an incentive to put them forward when efficiencies are treated positively by the agency and courts.

[27] For example, mergers can allow firms to take advantage of economies of scale, but if the market is growing the firms may also be able to achieve those economies through internal growth.

they may apply a stricter test, for example, not accepting them if there is just "some chance" they would be achieved anyway.[28]

(ii) Should the parties be given credit for efficiencies that could be achieved through less anticompetitive means, such as through a joint venture, internal growth or alternative mergers that pose less competitive risks? Again, the question of certainty must be addressed – how likely must it be that the efficiencies can be achieved in some less anticompetitive way.[29] If the alternative is a different merger, for example, the agency must decide if the standard should be that the alternative merger "would likely" take place or simply that it could take place.

(iii) Will cost reductions realized by the merging parties that represent transfers from other parties be considered?[30] There are, in general, two approaches here. If the efficiencies are being used to support an argument that the merged firm will be a better competitor to its rivals and so stimulate competition, then even efficiencies that represent transfers can be viewed as relevant. This possibility is provided for, for example, in the Australian Merger Guidelines (section 5.172). If, however, the efficiencies are being used to support a merger that will lessen competition, transfers are not relevant as they do not improve the allocation of resources.

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[28] The 1997 U.S. Merger Guidelines, for example, indicates that the agencies will consider efficiencies that are "unlikely to be accomplished in the absence of either the proposed merger or another means having comparable anticompetitive effect".

[29] This presents important challenges for the antitrust agency and courts because they will be forced to evaluate the efficiency of various alternatives without necessarily having access to the data they need. The 1997 U.S. Merger Guidelines indicate that, while the agencies while not consider efficiencies that could be achieved through some less restrictive means, they "will not insist upon a less restrictive alternative that is merely theoretical."

[30] These are sometimes referred to as pecuniary efficiencies. A merger than presents some tax-saving opportunities is the classic example. The tax savings are simply a transfer from the government tax authority (and ultimately other taxpayers) to the merging firms, and do not represent any real savings of resources. An ability of the larger (merged) firm to extract lower prices from suppliers can be similar – the savings are a transfer from those suppliers. However, if the lower prices from suppliers are due to certain efficiencies of dealing in larger orders, then the lower prices can represent real cost savings.

As this discussion makes clear, the answers to these questions will -- to a considerable extent -- turn on the way efficiencies are to be incorporated into the review of the merger.

1.2.7 Trading off efficiency gains and competition losses

Whether we are weighing the value of the efficiency gains against the cost associated with the reduced competition explicitly as part of the evaluation of an efficiency defense claim or implicitly as part of the determination of a lessening of competition, we need a standard to tell us when the merger passes or fails. Referring back to Figure 1 where the effects of the merger are illustrated by areas B, C, and E, we can put this another way: what formula do we use to combine the information in B, C and E to create our decision about whether the merger will be approved or not? Almost certainly we will consider the lost value represented by area C to be bad and to lower the chances of approval, just as we consider the efficiencies in E to be good and likely to improve those chances. The views about the transfer B are less clear.

Broadly speaking it would appear that five different standards have emerged over time and we discuss each here briefly.

(i) Price standard

(ii) Consumers' surplus standard

(iii) Total surplus standard

(iv) Hillsdown standard

(v) Weighted surplus standards

(i) Under a **price standard**, a merger is approved if the price will not increase as a result. In such an approach, efficiencies can be considered, but they will only save an anticompetitive merger (i.e. one that increases market power, perhaps as measured by the Lerner Index) if they are of such a magnitude that price actually falls (or does not rise) post merger. This approach is largely that of the U.S. authorities and it may be as far as their current law will let them take efficiencies.[31] Even to do this they need to combine the efficiency and lessening of competition

[31] Some might suggest that this is a slightly extreme view of the American approach and point to the 1997 Guidelines' indication that efficiencies will be considered even if they are not immediately passed on to consumers. See, e.g. Kolasky and Dick (2002), p. 43.

effects of the merger into one – essentially redefining "competition" so as to refer to the price level. Under this test, the merger illustrated in Figure 1 would not be approved, regardless of the magnitude of the efficiencies area E.

(ii) The **consumers' surplus standard** is very similar to the price standard, but it allows for other (nonprice) changes brought about by the merger that impact upon the surplus derived by consumers. For example, suppose two new telephone networks proposed a merger and that prior to the merger their services were incompatible so that calls could not be made from one to another. With the merger, the compatibility difficulties would be sorted out and consumers would enjoy greatly expanded calling opportunities. In Figure 1 this would translate into a shifting outward of the demand curve. In a case such as this, it is possible for prices to rise somewhat while consumers remain better off because of the product improvements (e.g. larger network) made possible by the merger. If a merger raises (or at least does not lower) consumers' surplus, it would be approved under this standard.

Notice that differences between the consumers' surplus standard and the price standard can also arise due to a deterioration of the quality of the product post-merger. This could be due, for example, to a reduction in variety as firms trim the number of brands produced. In this case a merger might pass a price test (because prices do not rise) but fail a consumers' surplus test (because the reduced quality lowers total consumers' surplus). Importantly, it could be the very steps that create efficiencies (reducing staffing levels or numbers of brands) that lower consumers' surplus.

(iii) The **total surplus standard** is also very easy to describe. Under this test a merger is approved if the sum of consumers' plus producers' surplus (or profits) increases after the merger. In the case of Figure 1, this means that A+B+E (post merger surplus) must be greater than A+B+C (pre-merger surplus), or simply that E is larger than C. Notice that, in this approach, the transfer of surplus from consumers to producers represented by B is considered completely neutral – it is neither a good thing nor a bad thing.

The total surplus standard has broad (but not universal) support among economists who recognize that other standards will sometimes sacrifice social surplus.[32] It is essentially the standard described by Williamson (1968) in his famous article. It has the advantage of relative simplicity – surpluses are simply added up with no special weighting attached to any particular groups. This means that we do not have to know anything about the consumers and producers except the effects on them of the merger – for example, we do not need to know if they are rich or poor buyers, or if the firms are large or small.

The total surplus standard appeared to be the standard guiding the Canadian Merger Enforcement Guidelines' interpretation of the efficiency defense in 1991, which continued to represent Competition Bureau policy until recently.

(iv) The **Hillsdown standard** derives from the obiter dictum in the (Canadian) Hillsdown decision in which Mme. Justice Reed suggested that she was far from certain that the total surplus standard was implied by the Canadian legislation.[33] As another possibility, she suggested that perhaps, under some conditions, the transfer of surplus from consumers to producers when prices increase post-merger should be viewed as a negative cost of the merger. Under the Hillsdown standard then, in our example in Figure 1, the benefits of the merger, as given by the efficiencies area E, would have to be larger than the loss in consumers' surplus, areas B+C. This standard is looser than the price standard – some mergers that raise price can still be approved if the efficiencies are great enough – but it is certainly tighter than the total surplus standard.

(v) Finally, under **weighted surplus standards**, the various effects of the merger are added together, as under the total surplus standard, but in this case each gets multiplied by some sort of "social weight" reflecting the importance attached to that group's welfare by the reviewing body.

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[32] Admittedly, total surplus as measured by economists is not necessarily the appropriate measure of social welfare we would like policy makers to use. Accordingly, we might be willing to sacrifice some surplus for other benefits – e.g. a preferred distribution of surplus.

[33] Canada (Director of Investigation and Research) v. Hillsdown Holdings (Canada) Ltd. (1992), 41 C.P.R. (3d) 289 (Comp. Trib.) . The characterization of this as the Hillsdown standard is due to McFetridge (1998).

For example, it could be that the weighted surplus is determined by adding the losses suffered by consumers due to higher prices (a negative number) to the profit gains of the firms where these profit gains are first multiplied by some weighting factor such as $^1/_2$. Under such a formula, $10 million of lost consumer surplus would exactly balance $20 million of new firm profits.

While, in principle, such a weighting scheme allows for considerable flexibility in the administration of merger reviews, the challenge is in its implementation. The key question becomes one of determining what the appropriate weights are. [34] To our knowledge, no jurisdiction explicitly follows a weighted surplus approach, though all of the standards other than the total surplus standard imply weights that are greater for consumers than producers. In addition, given the inherent uncertainty of the review process, it may well be that weights are created indirectly when agencies are more careful about protecting, for example, the surplus of certain groups of consumers. And the public interest tests applied in some jurisdictions such as Australia and the U.K. can allow for consideration of distributional implications of mergers.

As described above, the public interest/benefits tests employed in some jurisdictions are fundamentally different from the tests just described in that they may consider effects of the merger beyond those on consumers and producers. For example, they may consider effects on workers or local economies. When this is the case, it is difficult to determine what weight efficiencies receive since there are potentially so many factors at work determining if the merger is in the public interest.[35]

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[34] In an effort to try to operationalize the weighted surplus approach, Peter Townley suggested that the reviewing body (he was advising the Canadian Competition Bureau and addressing the Competition Tribunal) should first determine what relative weights for consumers and producers would make the net benefit or cost of the merger exactly zero. These weights are referred to as the "balancing weights". The reviewing authorities are then invited to compare the balancing weights to their perception of what would be a reasonable range for the true weights. In many cases it may be true that the balancing weights are far from what the reviewing authorities would apply. In such cases, the body may not need to settle on exactly what its precise weights are to determine if the merger should be allowed to proceed.

[35] For example, if we observe a merger approved in which the efficiencies are slightly greater than the deadweight loss, it could be because the public interest test is really just a total surplus test, or it could be that there was some

1.3 The Following Chapters

The chapters that follow describe the current policies related to the consideration of efficiencies in merger review in four jurisdictions: Australia, the European Union, the United Kingdom and the United States. To the extent possible we also provide some information about how these policies have evolved over the years, but it should be noted that apart from the United States, none of these jurisdictions have a very active history in this area. In the EU, for example, merger review has only existed (for all intents and purposes) since 1989. And while merger review has been a feature of competition policy in Australia and the United Kingdom for much longer, explicit discussions of the role of efficiencies have been few and relatively recent.

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other consideration (e.g. protecting the jobs of workers at a financially-weak merger partner) that was the main reason for the approval.

2 Australia

2.1 General Background

Competition law in Australia is provided for in the federal *Trade Practices Act* 1974 (hereafter, in this chapter, the "*Act*") which applies in all Australian states and territories. In broad terms, the *Act* covers anti-competitive and unfair market practices, mergers or acquisitions of companies, product safety/liability, and third party access to facilities of national significance.

The *Australian Competition and Consumer Commission* (the ACCC) was formed on 6 November 1995 by the merger of the Trade Practices Commission (TPC) and the Prices Surveillance Authority.[36] As an independent statutory authority the ACCC administers the *Act*[37] which applies to virtually all businesses in Australia. The ACCC is the only national agency dealing generally with competition matters and the only agency with responsibility for enforcement of the Trade Practices Act.

The review of mergers in Australia is provided for in s. 50 of the *Act*, which prohibits mergers that "would have the effect, or be likely to have the effect, of substantially lessening competition in the market". Therefore, as is the case in the United States and Canada, the *Act* provides for an SLC test in merger review. While there is no explicit provision for the incorporation of efficiency considerations in the *Act*, these can come up (and do come up) as part of a public benefits test under an application for authorization. Parties to a merger may seek authorization from the ACCC to proceed with their merger (under s. 88 of the *Act*) notwithstanding that there may be an adverse effect on competition, but the ACCC may not grant that authorization "unless it is satisfied that the proposed acquisition would result, or be likely to result, in such a benefit to the public that the acquisition should be allowed to take place." pursuant to s. 90(9) of the *Act*.

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[36] General Information on the Act from Rowley & Baker (2000).

[37] See Appendix A for relevant provisions of the Act.

The ACCC's decisions regarding authorizations can be appealed before the Australian Competition Tribunal (the Tribunal), which is located under the Federal Court of Australia.[38] The Tribunal is a review body. A review by the Tribunal is a re-hearing or a re-consideration of a matter and it may perform all the functions and exercise all the powers of the original decision-maker for the purposes of review. It can affirm, set aside or vary the decision.

2.2 Merger Review Process

There is no formal requirement that parties prenotify their intentions, however, parties commonly advise the ACCC prior to entering into agreements of proposed acquisitions and mergers. There is certainly some risk if the parties proceed with a merger that is found to violate the *Act* – penalties under s. 76(1) of the *Act* can reach up to A$500,000 for an individual and A$10 million for a corporation.[39]

In effect, there are three ways a merger can be reviewed under the *Act* in Australia;[40] (i) through an informal review process with the ACCC; (ii) through an application by the parties (to the ACCC) for authorization; or (iii) by contested proceedings (when the parties to a merger have not received an authorization) in which the ACCC can seek an injunction or (if completed) a divestiture. These three approaches for treating mergers will be explained separately below.

2.2.1 Steps in the Assessment

The assessment process that the ACCC initiates whether for an informal consideration, in a case of a potential breach of s. 50 and in the assessment of an application of authorization, is set out in chapter 5 of the Merger Guidelines. The Merger Guidelines has set up a 5-stage review:[41]

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[38] Information on the Federal Court of Australia is from: http://www.fedcourt.gov.au/aboutct/aboutct_act.html

[39] Merger Guidelines, June 1999, para. 4.27-28.

[40] See, e.g. Williams and Woodbridge (forthcoming).

[41] Merger Guidelines, June 1999, Figure 1, p. 29 and para. 6.35.

1. Market definition – The relevant market must be defined with regards to product, functional, geographic and time dimensions. Information on defining markets is found in paragraph 5.34-5.86 of the Merger Guidelines 1999. If the market is deemed to be substantial, a further analysis is needed, but if the market is not substantial, the merger will be allowed to proceed. Substantiality has not been considered by the courts in this connection, but in other contexts it has been determined to mean 'real or of substance'. Essentially, the concept of substantiality is a matter of assuring that *de minimis* matters are disregarded.
2. Market concentration is the next stage. As in Canada, the mere fact that the merger's concentration level is above the threshold does not mean that there is an automatic inference of a substantial lessening of competition. If an acquisition is above the thresholds given, a need for further quantitative analysis will be conducted. The Australian thresholds are as follows:
   (a) If a merger results in a post-merger combined market share of the four largest firms (CR4) of 75% or more and the merged firm will supply at least 15% of the relevant market, further investigation will be initiated, or;
   (b) If the merged firm will supply 40% or more of the relevant market.

   The two thresholds are designed to capture both mergers that have the potential of creating coordinated market power as well as unilateral market power. If a merger does not come within the thresholds it can proceed as proposed.
3. Insufficient import competition to ensure effective competition as a discipline on the merged firm will be considered. If such competition is not present, the ACCC will conduct further investigation into the market structure. Where import competition is sufficient the merger can proceed.
4. The likelihood of new entrants along with the existence of barriers to entry will be analyzed. If new entry to the market is likely, and the barriers to entry are low, the merger is not likely to lessen competition substantially. In absence of likely entry to the market, other factors must be considered.
5. If the ACCC concludes that a merger is likely to substantially lessen competition, it will consider other factors, which might alleviate the impact on competition. Where appropriate it will accept effective enforceable undertakings.

2.2.2 Informal Clearances

Parties to a merger are encouraged to engage in informal discussions with the ACCC as early in the process as possible. Discussions can be on a confidential as well as public level, although the ACCC cannot give final and binding views until market participants have been consulted. The parties must provide the ACCC with background information on the parties; the structure of the market, including relevant information on other major participants; the commercial rationale for the merger; and an analysis of the proposed acquisition in light of the factors in s. 50 (3) of the *Act*.[42]

According to Williams and Woodbridge (forthcoming), the ACCC conducts these informal reviews in such a manner so as "to consider the matters a court would consider under s. 50."[43] Where the acquisition appears to be likely to breach the *Act*, the ACCC will require the firms to provide additional information, and the ACCC can use its powers under s. 155 to secure information if the firms are uncooperative. The ACCC will be gathering information from, and consulting with, other participants in the market, such as competitors, suppliers, customers, industry associations, government agencies and departments, overseas agencies, consumer groups, and trade unions.[44]

Most mergers do not raise competitive concerns and are dealt with by the Merger Review Committee, which then reports its findings to the ACCC. Mergers that raise concerns are handled by the full ACCC.

For informal inquiries in confidentiality, the ACCC usually gives a response within 2-3 weeks. Where market inquiries are necessary for the ACCC to give a response the timelines can stretch up to 8 weeks, depending on the complexity of the matter.[45]

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[42] Merger Guidelines, June 1999, para. 4.9

[43] Which is not the same as how these matters might be considered by the ACCC under an application for authorization.

[44] Merger Guidelines, June 1999, para. 4.11

[45] Merger Guidelines, June 1999, para. 4.14

The parties have a number of options after receiving an informal response from the ACCC. Most informal considerations are cleared with a declaration that the merger does not breach the *Act*, in which case the parties can proceed with the merger. If the ACCC opposes the merger the parties have four options. First, the parties can choose to abandon the proposed merger. Second, the parties can modify the proposal to address any of the likely anti-competitive issues, formally or informally by way of undertakings, s. 87B of the *Act*, subject to approval by the ACCC. Third, the parties can apply for an authorization if they consider themselves able to establish that the merger will result in a net public benefit, s. 90(9). Or fourth, seek to complete the acquisition without the ACCCs informal approval, which puts them at risk for a s. 50 litigation process.

If the ACCC and the parties cannot agree on appropriate undertakings to remedy a merger problem, the ACCC will seek to stop the acquisition by way of an interim injunction from the Federal Court, under s. 80. In some rare cases the ACCC will seek an ex-parte injunction (i.e. without notice to the parties), if it finds it likely that notice to the parties may enable them to take some step to defeat the effectiveness of any injunction granted (e.g. when parties have declined undertakings, and there is a chance that they might close the deal before the injunction).[46]

If the firms consider that there are significant public benefits stemming from the merger, the merging firms can apply for an authorization (see below), which is a process of granting immunity, on public benefit grounds, for mergers and acquisitions that would or might otherwise breach s. 50 of the *Act*.[47]

The vast majority of mergers are handled by an informal consideration by the ACCC, and the decisions of the Commission are not published. Williams and Woodbridge (forthcoming)[48] identify a number of shortcomings with regards to the informal consideration process. First, the process is not based in the *Act*, but is outlined in the Merger Guidelines by the ACCC with their interpretation of s. 50 of the *Act*. The authors find that this gives a high level of uncertainty to the process. Second, the reasons behind decisions are not published, which creates a lack of formal

[46] Merger Guidelines, June 1999, para. 4.24-25

[47] Merger Guidelines, June 1999, para. 6.1 and 5.33.

[48] Williams and Woodbridge (forthcoming), p. 13.

guidance by means of precedent. As well as increasing the uncertainty of the process, the limited guidance enhances the ACCC's discretionary position. Third, the authors find that the lack of information gives the ACCC significant bargaining power, permitting it to engage in "administrative arm-twisting".[49] Williams and Woodbridge recognize that the secrecy and usually rather speedy decisions made in an informal consideration to be the main reasons for its popularity compared to the much less frequently used processes of applying for authorization and litigation under s. 50. Both applications for authorization and litigation under s. 50 involve a high degree of public exposure and are time consuming.

2.2.3 Application for Authorization

Much attention has been paid to the Australian system of authorization, however the the authorization option has not proven popular to date. In fact, since 1995 only 9 applications for authorization have been treated.

The Merger Guidelines defines an authorization as "... the granting of immunity, on public benefit grounds, for mergers and acquisitions which would or might otherwise contravene ss. 50 or 50A of the *Act*."[50] An authorization is given for a period of time, and can be conditional and subject to undertakings. The Tribunal can review the ACCC's decision. It is therefore within the authorization process' "public benefits test" that the ACCC can formally consider efficiencies.

Once parties have lodged their application the ACCC has 30 days, which can be extended to 45 days, to render a decision. Requests for information can extend the period even further. Within this period time the Commission must gather information from market participants and other interested parties. The process is very public, and apart from information that has been allowed to remain confidential, all information is placed in the public register. This is different from the informal process described above.

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[49] Williams and Woodbridge (forthcoming), p. 21.

[50] Merger Guidelines (1999), para. 6.1.

The determination of the application is published along with the detailed evaluation of all the factors of the case. The evaluation will, as under the informal consideration, follow the framework set out in the chapter 5 of the Merger Guidelines (see chapter 2.2.1 above).

The Merger Guidelines lists the kind of information that an application (at a minimum) must entail, and the application must also clearly specify the claimed public benefit. General statements regarding benefits are not going to be considered, but must be supported by factual material. The ACCC recognizes that there are difficulties inherent in measuring benefits, but nevertheless stresses the importance of submitting claims that are probable, not just possible or speculative, and achievable in a foreseeable future.[51]

2.2.4 Litigation for Breach of s. 50

Since the *Act* came into force in 1974 there have only been four fully argued merger cases, and none of these have considered efficiencies. Furthermore, all four cases were argued under the *dominance test*, which has since been replaced by the SLC test. This creates a lack of precedent in the litigation of mergers for breach of s. 50. Consequently, very limited information on the litigation of mergers exists.

The process for finding a substantial lessening of competition is likely to follow the five-step system that the ACCC has set out in the Merger Guidelines, and will involve an analysis of all the factors set out in s. 50(3).

While there is not the same scope for introducing evidence on efficiencies that is provided by the public benefits test in authorizations, efficiencies might be relevant in a s. 50 analysis if they can be seen to have an impact on the level of competition in a market. The Merger Guidelines acknowledge that a merger might increase the competitiveness of the merged firm, and may therefore also increase (or not substantially lessen) competition in a market. Therefore efficiencies can be integrated in the framework of competition analysis, but is not to be considered a 'trade-off' against an SLC -- as it could potentially under an application for

[51] Merger Guidelines, 1999, para. 6.48.

authorization. The ACCC finds that "the relevant question is the effect or likely effect of the merger on firms' abilities and incentives to compete in the relevant market, including any effects flowing from efficiencies."[52] Williams and Woodbridge (forthcoming) also speculate that efficiencies may be relevant under s. 50 in regards to whether the lessening of competition is substantial, but they are cautions because of the lack of jurisprudence in this field.

2.3 Historical Context and Evolution of the Role of Efficiencies

Australia has had merger control legislation since 1906 in the Australian Industries Preservation Act, which imitated the United States Sherman Act. The *Act* had a short life and was abolished in 1909. In 1965 Australia enacted the Australia Act, based on the then United Kingdom Model, although without any explicit merger control provisions.[53] With the current Trade Practices Act 1974, Australia returned to the US model. Between 1974-77 the test used by Trade Practices Commission (now ACCC) for merger regulation was a *competition test* (substantial lessening of competition) rather than a *market dominance test*. In 1977 the *Act* was amended to adopt a *market dominance test*, but after a failed proceeding[54] the Trade Practices Commission was very cautious in resisting mergers. In 1986, s. 50 was slightly amended to control for redundant wording, and the market dominance test was reinforced. Also, the *Act* was amended with s. 50A, which regulates acquisitions outside Australia. The market dominance test was finally abolished in 1992 with the *Trade Practices Legislation Amendment Act 1992*, which changed the test back to a *substantial lessening of competition test* and the merger guidelines were amended to reflect the amendments of the *Act*. Only four mergers have been tried under s. 50, and all under the dominance criterion.

With the Australian merger review system being rather young, there is not much historical information on the evolution of the treatment of efficiencies to report. As stated above, none of the four merger cases litigated involved efficiencies. Also, efficiencies are only considered to be playing a small, and at the present, a fairly undefined role in a s. 50 analysis.

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[52] Merger Guidelines, June 1999, para. 5.17.

[53] Rowley & Baker (1996) and Corones (1994).

[54] Trade Practices Commission v. Ansett Transport Industries (Operations) Pty Ltd (1978) 32 F.L.R. 305.

The current precedent for treatment of efficiencies in what could be denoted an efficiencies defense, is set in applications for authorizations, pursuant to s. 90(9), and the Tribunal's hearing of appeals on the same matters. The granting of authorizations for mergers has been part of the law since it was enacted in 1974. Section 90(9) and (9A)[55] sets out provisions for mergers to be authorized despite the likelihood of a merger substantially lessening competition pursuant to s. 50. It has not been clarified in the *Act* what determines a benefit to the public, nor how large a benefit must be, to clear a merger that is in breach of s. 50. This has been left for the ACCC and the Tribunal to decide. The authorization process gives us guidance on the wider concept of public benefit, and this will be treated below.

2.4 Definition and Measurement of Gains in Efficiency

Efficiency arguments under informal considerations and litigation for breach of s. 50 as interpreted by the ACCC, are generally the same and are explained together below. Following that, the rules for arguing efficiencies in an application of authorization are defined.

2.4.1 Efficiencies in Informal Considerations and in Litigation for Breach of s. 50

The Merger Guidelines express that efficiencies are to be dealt with under an application of authorization. Hence, parties that anticipate efficiencies playing an important part of clearing their merger should raise these arguments in an application for authorization, not under an informal consideration.[56] As mentioned above, the reasons behind decisions in informal considerations are not published, meaning there is very little information, apart from the ACCC's merger guidelines, to demonstrate the treatment of efficiencies.

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[55] Subsection (9A) was inserted pursuant to the1992 amendments to the Act.

[56] This is the official line on how information on efficiencies is to be introduced. However, since efficiency arguments would be relevant in an application for authorization, it is possible that ACCC officials listen to them as part of the informal clearance process. The point of such informal processes is typically to achieve the same ends as the formal processes in a more expeditious and less costly (and perhaps also more confidential) manner. If the alternative formal process is authorization, ACCC officials might consider the public benefits of the merger in an informal review. However, we have no confirmation that this is indeed what happens.

As noted above, the ACCC nevertheless acknowledges that efficiencies can form part of the analysis if they contribute to enhance competition in the market. The Merger Guidelines indicate that:

> "The weight and significance accorded to different types of efficiencies should be a function of their magnitude and probability, the degree to which they likely will enable the merged firm not only to be a better competitor but to enhance (or not lessen) competition and thus benefit consumers, and the delay with which these consumer benefits are to be realized."[57]

It is clear from the quote that efficiencies in a s. 50 analysis can not be a defense to a merger that lessens competition. Efficiencies must be substantiated in order to ascertain their magnitude, and they must be probable. The less substantiated and probable the efficiencies are, the less likely it is that they will have any effect in the analysis. The claimed efficiencies must enable the merged entity to compete better and enhance competition in the market, thereby benefiting consumers. If there is any delay in this benefit reaching consumers, this will seemingly also give less weight to the claimed efficiencies.

Also, if efficiencies create a new or enhanced competitive constraint on the unilateral conduct of other firms in the market, or contribute to undermining coordinated conduct in the market, the merger is less likely to substantially lessen competition. If the efficiencies claimed "are likely to result in lower (or not significantly higher) prices, increased output and/or higher quality of goods or services, the merger may not substantially lessen competition."[58]

The ACCC acknowledges that efficiencies cannot be precisely quantified, but will required strong and credible evidence that "such efficiencies are likely to accrue and that the claimed benefits for competition are likely to follow."[59]

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[57] Merger Guidelines, 1999, para. 5.17. The ACCC's quote stems from a report by the Federal Trade Commission Staff: "Anticipating the 21st Century: Competition Policy in the New High-Tech Global Marketplace", Antitrust & Trade Regulation Report, Vol. 70 No.1765, Special Supplement, 6 June 1996, p. S-36.

[58] Merger Guidelines, 1999, para. 5.172-3

[59] Merger Guidelines, 1999, para. 5.174

As indicated above, none of the four merger cases that have been litigated have dealt with the issue of efficiencies under a breach of s. 50.[60] Therefore, it is unknown at this point how the courts would treat efficiencies arguments. It would appear, however, that the courts will not engage in a balancing of efficiency benefits against a loss of competition. To the extent this might be possible, this is for the authorization process. For example, in Davids (1993) on a matter of an appeal of the ACCC's (at that time TPC) decision not to grant authorization one judge comments:

> "Provisions such as s. 50 are not tools designed to enable the Court to strike a balance between the economic advantages that might flow from the economies of scale and other efficiencies resulting from a particular merger, on the one hand, and the economic detriments of the merger, such as increased prices that consumers may have to pay, on the other... Any such balancing exercise is for the Trade Practices Commission to carry out in dealing with an authorisation application under ss. 88(9) and 90(9), not the Court that has to consider whether s. 50 bars a particular merger."[61]

Further, Corones (1999) states that since efficiencies were mentioned in earlier versions of s. 50(3), but ultimately taken out of the provision, the courts could interpret this as the Parliament's intention not to treat efficiencies in a s. 50 litigation.[62] In *Arnotts*[63] (one of only four mergers that have been heard by the Courts) the subject of economies of scale played a role, but the subject here related to market power that existed in market for biscuits.

Thus we conclude that the treatment of efficiencies in a s. 50 analysis, whether in the form of an informal consideration or litigation is apparently not very developed. We turn now to the subject of applications for authorizations.

2.4.2 Efficiencies in Applications for Authorization

As mentioned above, the *Act* does not define the concept of public benefit, but a number of cases relating to authorizations of mergers have treated the subject. Other cases, regarding other

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[60] Williams & Woodbridge (forthcoming).

[61] *Davids Holding Pty Ltd v Attorney-General (1994) 49 FCR 221; ATPR 41-304 at 42,098*:

[62] Corones (1999), p. 220.

[63] Re Arnotts Ltd v. TPC (1990) 24 FCR 313

competitive restraints, have also given consideration to public benefit, and these give a good indications as to the Tribunal's and the ACCC's definition of public benefit.

As indicated, an authorization is a granting of immunity from an assessment under s. 50, where the ACCC finds that the merger creates public benefits that outweigh the detriment to competition. On the matter of what is "public" the Tribunal in the *Re: Howard Smith Industries Ltd.* case established that:[64]

(a) the term "public" refers to the Australian public;

(b) the term "public" is wider than simply consumers and would permit consideration of the achievement of economies of scale even if the cost saving is not passed on to consumers through lower prices; and

(c) a benefit to shareholders through higher dividends may amount to a benefit to the public, but one that might be given less weight because it is not spread widely throughout the community.[65]

There is also guidance with respect to what counts as a benefit. Some came in *Re 7-Eleven Stores*, which concerned a redetermination by the Tribunal of an authorization granted by the ACCC of a more flexible system regarding the distribution of newspapers. The Tribunal overturned the ACCC's determination, and states:

> "Public benefit has been, and is, given a wide ambit by the Tribunal as, in the language of QCMA..., 'anything of value to the community generally, any contribution to the aims pursued by society including as one of its principal elements (in context of trade practices legislation) the achievement of the economic goals of efficiency and progress'. Plainly the assessment of efficiency and progress must be from the perspective of society as a whole: the best use of society's resources. We bear in mind that (in the language of economics today) efficiency is a concept that is usually taken to encompass 'progress': and that commonly efficiency is said to encompass allocative efficiency, production efficiency and dynamic efficiency."[66]

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[64] (1977) 28 F.L.R. 385.

[65] See Rowley and Baker (2000), p. 3-9.

[66] Re 7-Eleven Stores Pty Ltd (1994) ATPR 41-357, and see Miller (2002), p. 756.

The Merger Guidelines report that the Tribunal holds that "public benefits in the form of increased efficiency and better resource usage, resulting in lower unit costs, are *most important* in the consideration of applications for the authorization of mergers (emphasis added)."[67] These can consist of economies of scale and scope, more efficient technology resulting in reduced input or energy costs or combining complementary R&D facilities.[68]

It is clear the public benefit has a very broad definition. In *Re ACI Operations*[69] the ACCC accepted that there were public benefits in the applicant's acquisition of the only other glass container manufacturer in Australia. The ACCC listed a number of points, which in its view could also constitute public benefits when considering authorizations. These involved economic development, promotion of industry cost savings, fostering business efficiency and industrial rationalization, which are related to efficiencies. Other issues, which revolve more around social goals, could also constitute public benefits. These include expansion of employment or prevention of unemployment, and employment growth in particular regions. Improvement of product choice, quality, safety and information for consumers are relevant in assessing public benefits, as well as assistance to small businesses with regards to guidance on costing, pricing or marketing initiatives to promote competitiveness. Import replacement and growth of export markets are given a fairly important role, and are also the only factors represented in the *Act* that must be considered, s. 90(9A).[70] Lastly, steps to protect the environment are also considered a public benefit.

It is also important that claimed efficiencies are durable. In the recent *Australian Pharmaceutical* case [71] the ACCC found that although efficiencies were considerable, they were "likely to be dissipated over time. The loss of competitive tension in the market is likely to result in a

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[67] Merger Guidelines 1999, para. 6.39.

[68] See, e.g., the case *Email Ltd./Simpson Ltd.* ATPR (CCH) ¶ 50-001 (1981). The case is discussed in Griffin and Sharp (1996), at 680.

[69] Re ACI Operations Pty Ltd (1991) ATPR (Com) 50-108

[70] As of the 1992 amendment of the Act. Import and export considerations have been mentioned in the Guidelines since 1986.

[71] Re Australian Pharmaceutical Industries Limited and Sigma Company Limited, A30215, 11 September 2002

lessening of the dynamic elements driven by competition and that greatly influence market development." The market participants would be reduced from three to two, had the merger been allowed.

It seems clear that the competitive impact of the merger must always be considered, even in the presence of other accepted public benefits. In *QCMA* the Tribunal determined that in order to assess the benefits to the public it is necessary to assess the competitive impact of the merger. The case concerned a merger between flourmills. It indicated that:

(a) "A merger may positively enhance the competitive process and thus give rise to a substantial benefit. ...
(b) But the benefits claimed may not mention competition. ... Nevertheless, our appraisal of all the listed claims must depend upon our appreciation of the competitive functioning of the industry, with and without the merger. ...
(c) A claimed benefit may in fact be judged to be a detriment when viewed in terms of its contribution to a socially useful competitive process. ...
(d) ... the substantiality of benefits needs to be measured against likely anti-competitive effects (and other detriments).
(e) Quite generally, the Tribunal's role is seen as forming one of the means of achieving the policy objective of the Act, namely the preservation and promotion of useful competition."[72]

Significantly, this case and others also revealed that the Tribunal was evolving what Williams and Woodbridge (forthcoming) call a "future-with-and-without test". In such a test, the level of competition post-merger is compared to the level of competition that would exist in the future if the merger were not permitted. The relevant comparison is not with past levels of competition if they cannot be expected to remain the same.[73]

It is also clear that it is not necessary to establish an SLC before the public benefits can be considered. The Tribunal has stated that in granting an authorization it is not appropriate or necessary to express any views, as to whether the merger would likely breach s. 50, but the

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[72] Re Queensland Co-operative Milling Assn Ltd (1976) ATPR 40-012, see Merger Guidelines, June 1999, para. 6.33.

[73] The Merger Guidelines indicate that the current method used by the ACCC, involves "comparing the position that would apply in the future were the proposed acquisition not given effect, with the position in the future which would arise if the proposed acquisition were given effect." Merger Guidelines, June 1999, para. 6.29.

framework that is established in chapter 5 of the Merger Guidelines still useful in assessing the competitive effects of the merger.

2.5 The Methodology and Welfare Standard Employed

2.5.1 Informal Considerations and breach of s. 50

According to the Merger Guidelines efficiencies are only considered in the competitive effects analysis when claimed efficiencies enable the merged firm to enhance competition in the market. In the quote given (see chapter 2.4.1.) the enhanced competition must "thus benefit consumers" and if there is any "delay with which these consumer benefits are to be realized" this will be counted against the efficiency claim. Also, the efficiencies must benefit competition, and not as under an application for authorization benefit the public.

Here the welfare standard appears to be a consumers' surplus standard, as defined in chapter 1 above.

2.5.2 Application for Authorization

Miller (2002) says that the methodology in satisfying the s. 90(9) is for the ACCC to conduct a weighing of the detriments and benefits. The ACCC has not specifically designated a weighing of resulting benefits to the public against resulting detriment, the anti-competitive effect. The test is whether the ACCC is satisfied that there is a net or overall benefit after any detriment to the public has been taken into account.[74]

In QCMA, the Tribunal stated:

> "We accept that the statute calls upon us to adopt a balance-sheet approach: we must balance the likely benefits and detriments flowing from the acquisition"[75]

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[74] Miller (2002), p. 764.

[75] Merger Guidelines, June 1999, para. 6.31.

There is some suggestion that the relevant standard under authorizations could be a total surplus standard as described above in chapter 1. Corones (1999) concludes that as "long as the claimed public benefit involves a reduction in social costs, it does not matter that the cost saving is not passed on to consumers in form of lower prices; however, it would be necessary to have regard to how widely the cost savings is shared among the group of beneficiaries."[76] The Tribunal in *QCMA* indicated that private benefits (e.g. to the shareholders of merging firms) could be considered as public benefits. And in the *7-Eleven Stores* case quoted above (in section 2.4.2), the Tribunal stated that "the assessment of efficiency and progress must be from the perspective of society as a whole: the best use of society's resources."

Of course it is one thing to say that shareholders count and another to go all the way to a total surplus standard in which a dollar of surplus to a shareholder carries the same weight as a dollar of consumer's surplus. Our view of the Australian experience is that, while the door may be open to a total surplus approach in authorization cases, it is far from clear that the ACCC and Tribunal are prepared to go this far.[77]

However, it is clear that the welfare standard employed by the ACCC and the Tribunal in applications for authorizations is different from that employed in other merger cases.

2.6 Efficiencies Gains and Consumers

As just suggested, it would appear that there is no absolute requirement that efficiency gains are passed on to consumers, but consumers are a relevant factor. The Merger Guidelines state that in granting authorizations, it is relevant to analyze how reduction in competition affects the ultimate consumers.[78]

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[76] Corones (1999), p. 55.

[77] The discussion of the *Howard Smith* case below also suggests that shareholders might not get full weight in all cases.

[78] Re Rural Traders Co-operative (WA) Ltd. & Ors. (1979), ATPR 40-110, see Merger Guidelines, June 1999, para. 6.36.

In *Howard Smith*, in which an application for an authorization of a joint venture between towing companies was denied, the Tribunal stated:

> "If a merger is likely to result in the achievement of economies and a considerable cost saving in the cost of supplying a good or service this might well constitute a substantial benefit to the public, even though the cost saving is not passed on to the consumers in the form of lower prices. Nevertheless, if such a merger benefited only a small number of shareholders of the applicant corporations through higher profits and dividends, this might be given less weight by the Tribunal, because the benefits are not being spread widely among the members of the community."[79]

The result of *Howard Smith* appears to be that consumers need not benefit from the merger, but benefits do need to reach more than the shareholders of the merged firm. Also, in *Rural Traders*[80] it was accepted that private benefits are not irrelevant,[81] resulting in the ACCC stating in the Merger Guidelines that benefits to the public are not limited to benefits to consumers. Furthermore, the ACCC acknowledges that even if a merger creates economies of scale or other resource savings, these might not immediately be available to consumers through lower prices. The fact that there is an overall resource saving in the community is of interest.

In the recent case, *Australian Pharmaceutical*[82] the ACCC denied the authorization, concluding that efficiencies would likely "be retained by the merged entity for its benefit, and the benefit of its shareholders." Efficiencies achieved must benefit more than its shareholders.

In *Dupont*[83] the resource savings and efficiencies flowing from the merger in the production of sodium cyanide, which involved savings in electricity and capital, and significant environmental benefits, were unlikely to result in lower prices for the consumers. The authorization was granted despite leaving only three firms, each with about 30% market share, to compete with a very low level of import competition.

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[79] (1977) 15 ALR 645, See Corones (1994) p. 375.

[80] Re Rural Traders Co-operative (WA) Ltd. & Ors. (1979), ATPR 40-110.

[81] Miller (2002), p. 757

[82] Re Australian Pharmaceutical Industries Limited and Sigma Company Limited, A30215, 11 September 2002

[83] Re Dupont, CA 95/23-24.

To sum up on this point, then, we note that in applications for authorization efficiencies need not be passed on to consumers. In an informal consideration, the Merger Guidelines demand that efficiencies included in the analysis of a mergers effect on competition must enhance competition in ways that benefit the consumers through lower prices, wider choice of products or better quality.

2.7 Merger specificity

The Merger Guidelines require that the claimed efficiencies are merger specific, when concerned with applications for authorizations, hence parties must clearly set out how these are related to the merger:

> "Applications for authorisation should clearly set out the claimed public benefits, how they relate to the proposed merger, their likely magnitude and timing. It is often difficult to measure public benefits in precise quantitative terms. Nevertheless, general statements about possible or likely benefits will not be given much weight unless supported by factual material."[84]

2.8 Attainability of efficiencies in a less anti-competitive manner

The Merger Guidelines states that "(t)he phrase 'not otherwise available' previously formed part of the public benefit test. This is no longer an absolute requirement." There must still be a connection between the benefits claimed and the merger. It is the ACCC's view that it is still relevant whether the benefits are otherwise attainable, when comparing the scenarios existing with or without the merger, in which case benefits attainable in a less anti-competitive manner would receive less weight in the analysis.[85]

The most recent application for authorization in *Australian Pharmaceutical*,[86] concerned a merger between two full-line pharmaceutical wholesalers, resulting in a combined market share of 60% in some markets, and leaving only one remaining competitor. In its denial of the application, the ACCC indicated that the parties failed to prove that the claimed benefits, which

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[84] Merger Guidelines, June 1999, para. 6.49.

[85] Merger Guidelines, June 1999, para. 6.37.

[86] *Re Australian Pharmaceutical Industries Limited and Sigma Company Limited*, A30215, 11 September 2002

included enhanced efficiency in the distribution of pharmaceuticals, would not be achievable without the merger.

Increased bargaining power is considered to be pecuniary savings and merely a transfer of wealth, and cannot in itself be considered a public benefit. Such savings were rejected in *Wattyl,*[87] where the second largest paint company wanted to acquire the third largest. High barriers to entry and little import competition in a highly concentrated market contributed to that decision.

2.9 Elimination or Near Elimination of Competition

The Merger Guidelines does not directly specify that gains in efficiency can justify or offset the elimination or near elimination of competition. However, the ACCC may be open to the possibility. In a recent speech, Commissioner Ross Jones reported that:

> "... in granting authorisation the Commission is giving immunity from a significant economic principle. It is allowing firms to substantially lessen competition, and thereby gain substantial market power, even monopoly power."[88]

Some cases give evidence to Commissioner Jones' statement. In *Davids* (1996), [89] an application for an authorization to acquire QIW was successful. The merger was the last of a number of concentrations in the independent grocery wholesaler market, the previous one being a vertical integration of retail stores. The merger was allowed because of public benefits found , despite the fact that it would leave Davids as the only independent wholesaler in the market. Among the benefits to the public were considerable savings in warehousing and distribution facilities, advertising and improved generic product ranges. Although competition was substantially lessened in the independent wholesaler market, the merger would enable the independent retailers to enhance their competition with the supermarket chains.

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[87] Re Wattyl (Australia) Pty Ltd., Courtaulds (Australia) Pty Ltd. (1996) ATPR 50-232.

[88] Commissioner Ross Jones speech at The Thirteenth Annual Workshop of The Competition Law and Policy Institute of New Zealand: "The Rationale for Merger Laws", August 2nd 2002, p. 17.

[89] Re Davids Limited in relation to its proposed acquisition of QIW Limited, Case No: CA96/3.

In the case of *Pasminco Ltd,*[90] the joint venture between Australian Mining & Smelting Ltd and North Broken Hill Holdings Ltd. was allowed due to enhanced international competitiveness and an increase in the value of exports. This was despite the fact that the merger would leave only one producer in the Australian market, which would then be in a position to dominate the market. The ACCC found that a number of efficiencies flowed from the joint venture, among which were rationalization benefits from production synergies.

In *Adelaide Brighton,*[91] it was determined that the merger would substantially lessen competition in one market in Western Australia, but give rise to public benefits from rationalizations, and an increase in competition in other markets in Australia, (also considered a public benefit).

In *Australian Pharmaceutical*, the reduction of competitors from three to two was considered to reduce the competitive tension in the market. The claimed efficiencies were considered to be likely in the magnitude calculated by the parties, and would enhance competitiveness in other areas, such as import replacement or increased exports.

The conclusion is that at the very least, the elimination of competition in one or more markets may be allowed if the associated efficiencies enable the merged firm to better compete in other markets, either domestically or internationally.

2.10 Efficiencies in the Review of other Competitive Restraints

Horizontal anti-competitive agreements are covered by s. 45 of the Trade Practices Act, which prohibits agreements between competitors, which have the purpose or effect of fixing, maintaining or controlling prices.[92] Other agreements which entail elements of price fixing or market sharing as an ancillary restraint are not prohibited per se, but will be prohibited if they substantially lessen competition. In order for an agreement to be allowed the parties must show

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[90] (1988) ATPR (Com.) 50-082.

[91] *Re Adelaide Brighton/Cockburn Cement*, A90682, 30 April 1999.

[92] Corones (1999), pp. 155-184.

that the purpose of the agreement will give the parties some sort of benefit, which improves their ability to supply goods or services to the market. The benefit must be shared between the parties, and not benefit just one party. Purposes, which are commercially necessary, appropriate or reasonable, are acceptable. All types of agreements can be authorized by the ACCC upon application as seen above in the case of mergers. It must be proven that there are benefits to the public and that the benefit would outweigh the detriment to the public flowing from the agreement, pursuant to s. 90(6). As indicated, when assessing benefits to the public, the most important element is efficiency.

Likewise, engagement in exclusive dealing[93] is prohibited if the purpose or effect is to lessen competition substantially, pursuant to s. 47 of the Act. As with anti-competitive agreements above, exclusive dealing will not be prohibited if the purpose of the arrangement is not anti-competitive. Exclusive dealing can be allowed regardless of it breaching s. 47 if the ACCC accepts a notification, which is a process similar to that of applying for authorization. Contrary to application of authorization, the party notifying a conduct does not have to await the ACCC's decision to accept the notification, but can notify after the conduct has been commenced. The ACCC can revoke immunity for exclusive dealing if it considers the conduct substantially lessens competition and that in all the circumstances there appears to be no countervailing public benefit; or any public benefit does not outweigh the detriment to the public resulting from the lessening of competition.

[93] Corones (1999), pp. 241-271.

3 The European Union

3.1 General Background

Ever since the establishment of the European Coal and Steel Community (ECSC) in April 1951 competition policy has been a central feature of European Union (EU) policy. This was reinforced in the *Treaty Establishing the European Economic Community* (EEC, now *EC Treaty*, as it will be titled throughout this report) in Rome in March 1957, which came into force in 1958. The ECSC Treaty had already contained competition rules regarding mergers, which remain in force when one or more undertakings in the coal or steel industry merge, ECSC Treaty Article 66, meaning that mergers are subject to prior authorisation by the Commission. The ECSC Treaty is still active (although officially scheduled to come to an end in 2002)[94] and runs alongside the European Atomic Energy Community and EC. Therefore, when competition issues arise in the area of either ECSC or EAEC, the *EC Treaty* is still applicable except when pre-empted by express *lex specialis* provision in the Treaties.[95]

The *EC Treaty* did not include regulation of mergers because, at the time of implementation, Europe's industry was rather fragmented (after the Second World War), and concentrations were perceived as a means to integrate Europe.[96] By the mid 1970's debate began regarding the desirability of including mergers into the *Treaty* or whether to provide a separate legislation by way of a Council Regulation. Ultimately, the review of mergers was provided for in the *Merger Regulation* in 1989.[97]

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[94] ECSC Article 97. It is still unknown what will happen to the Treaty, whether it will be renewed or simply be incorporated into the EC Treaty.

[95] Lane (2000), p. 21.

[96] Lane (2000), p. 256-7.

[97] Council Regulation 4064/89 as amended by Council Regulation 1310/97.

3.2 Merger Review Process

The *Merger Regulation* adopts a dominance test. Under Article 2 (3), a merger will be prohibited if it creates or strengthens a dominant position:[98]

> Article 2 (3): A concentration which creates or strengthens a dominant position as a result of which effective competition would be significantly impeded in the common market or in a substantial part of it shall be declared incompatible with the common market.

A merger within the meaning of Article 3(1)(a) of the *Merger Regulation* occurs when two or more independent undertakings amalgamate into a new undertaking and cease to exist as separate legal entities.[99]

The Commission has sole competence to make any decisions for which the *Merger Regulation* provides.[100] Cases determined by the Commission are subject to review by the Court of First Instance, and subsequently the Court of Justice, but on points of law only, according to Article 225(1) of the *EC Treaty*.

In order for the Commission to have jurisdiction over a concentration, the concentration in question must have Community dimension. The *Merger Regulation* sets forth thresholds, which will identify whether a merger is of Community dimension as defined in Article 1 (2) and (3). Community dimension is subject to two tests. The first test is that the aggregate worldwide turnover of all the undertakings concerned must be more than ECU 5000 million, and the aggregate Community-wide turnover of each of at least two undertakings must be over ECU 250 million.[101]

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[98] Council Regulation (EEC) No 4064/89 of 21 December 1989 on the control of concentrations between undertakings (hereinafter called the Merger Regulation). See appendix B for the full text of Article 2 of the Merger Regulation.

[99] Commission Notice on the concept of concentration, para. 6.

[100] Council Regulation 4064/89, Article 21(1).

[101] Council Regulation 4064/89, Article 1(2)

If a merger does not come within the thresholds of this first turnover test, a second test is applied, under Council Regulation 1310/97, to establish whether the merger nevertheless is of Community dimension. These thresholds are met where:[102]

- the combined aggregate worldwide turnover of all the undertakings concerned is more than ECU 2,500 million;
- in each of at least three Member States, the combined aggregate turnover of all the undertakings concerned is more than ECU 100 million;
- in each of those three Member States, the aggregate turnover of each of at least two of the undertakings concerned is more than ECU 25 million; and
- the aggregate Community-wide turnover of each of at least two of the undertakings concerned is more than ECU 100 million;
- unless each of the undertakings concerned achieves more than two-thirds of its aggregate Community-wide turnover within one and the same Member State.

Both tests are exempted if each undertaking achieves more than two-thirds of its aggregate Community-wide turnover within one and the same Member State, in which case the merger is surrendered to the competent authority in the Member State concerned.[103] This is referred to as the "one-stop shop" principle, which means that the Commission has exclusive competence to assess concentrations with Community dimension, and the merging undertakings need only make one notification within the Community.[104] It still leaves room for treatment of mergers by the Member State, when the great majority of the undertakings' turnover is generated only in that Member State.

Notification of a concentration with a Community dimension is mandatory within a week of the conclusion of an agreement or acquisition of a controlling interest pursuant to the *Merger Regulation*, Article 4(1).

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[102] See Rowley and Baker (2001), p. 17-18.

[103] Council Regulation 4064/89 Article 1(2) and (3), and Article 9.

[104] Community Merger Control, Green Paper on the Review of the Merger Regulation, 1996, p. 6.

The Commission's task in merger appraisals is to assess whether or not a merger is compatible or incompatible with the Common market, according to Article 2(1) of the *Merger Regulation*. Within one month[105] of the notification of a concentration, the Commission must assess and give notice whether the merger raises no competition questions, hence the merger is compatible with the Common market and can proceed,[106] or whether the concentration gives rise to *serious doubt* as to its compatibility[107], in which case the Commission will investigate the merger further. The '*serious doubts*' are aimed at the concentrations which "*creates or strengthens a dominant position as a result of which effective competition would be significantly impeded*", pursuant to Article 2 (3) of the *Merger Regulation*. The preamble to the *Merger Regulation* provides a "safe harbour": it provides that mergers with a post-merger market share of less than 25% are less likely to raise competition concerns.

In order to assess whether the initial doubts about the character of the merger are reasonable, the Commission launches an investigation that can last no longer than four months[108] after which time the Commission must render a decision.

Effective competition is defined as being significantly impeded if the merging firms are able to behave fairly independently of their remaining competitors, without losing market share, and there is a lack of potential entrants capable of eroding that position.[109] Thus, a dominant position is defined as the "*power to behave to an appreciable extent independently of these competitors or to gain an appreciable influence on the determination of prices without losing market shares*".[110]

While the degree of dominance is determined by more than a firm's market share, it is important to recognize that to be dominant under the *Merger Regulation* does not require that a firm have a

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[105] Council Regulation 4064/89, Article 10(1).

[106] Council Regulation 4064/89, Article 2(2) and 6(1b).

[107] Council Regulation 4064/89, Article2(3) and 6(1c), as amended by 1310/97.

[108] Council Regulation 4064/89, Article 10 (3)

[109] Brittan (1991), pp. 36-38.

[110] Case No IV/M004 - Renault/Volvo, Date 07.11.1990.

monopoly or near-monopoly. A review of the cases and some of the Commission's writings suggests that dominance concerns can arise when market shares approach 50%.[111]

3.3 Historical Context and Evolution of the Role of Efficiencies

As indicated, competition law has been a part of Community law since the coming into force of the EEC Treaty in 1958. The fact that competition law has a prominent place in the European Union is evident in the Preamble, where it is stated "*that the removal of existing obstacles calls for concerted action in order to guarantee steady expansion, balanced trade and fair competition.*"[112] Also, the principles laid out in Part 1 of the *Treaty* gives the Community authorization and obligation to create "*a system ensuring that competition in the internal market is not distorted*", relative to Article 3(1)(g), in order to carry out the 'tasks' of Article 2.

The principles of the *Treaty*, as evidenced above, have an emphasis on integration to ensure the goals of the European Union, with the integration of the economies of the member states and protection of the internal market being front and centre. It is important to keep in mind the larger objectives of the European Union when examining EC Competition rules and other legislation.

Prior to the *Merger Regulation*'s implementation in 1989, only two mergers[113] had been considered pursuant to Art. 82 of the *EC Treaty*. The application of Article 82's monopolization provisions on mergers was very limited though as it only applied to mergers where one undertaking already held a dominant position. It did not permit consideration of cases in which a merger creates a dominant firm. It was also established that Article 81's restrictions on agreements between firms that lessen competition could be applied to mergers, though since the adoption of the *Merger Regulation* neither Article 81 nor 82 have been used for mergers.[114]

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[111] OCDE/GD(96)65, p. 54. The minimum threshold for dominance may be lower. Griffin and Sharp (1996) p. 664 report the view that a market share of 40% may be sufficient to raise suspicions of dominance.

[112] EC Treaty Preamble

[113] See Europemballage and Continental Can v. Commission (6/72), ECR 215 and Commission Decision in Tetra Pak I, 26.7.1988, L 272/27.

[114] Rowley and Baker (2001), pp. 17-44.

With formal merger review really only beginning a little over a decade ago, the historical evolution of efficiencies in mergers is not very developed. In fact, as will be seen, it is difficult to determine just what is the role of efficiencies in merger review in the EU

3.4 Definition and Measurement of Gains in Efficiency

The requirements for the assessment of mergers within the jurisdiction of the Commission are outlined in Article 2(1). This requires a broad market analysis involving, but not limited to:

> "a) the need to preserve and develop effective competition within the common market in view of, among other things, the structure of all the markets concerned and the actual or potential competition from undertakings located either within or without the Community;
> b) the market position of the undertakings concerned and their economic and financial power, the alternatives available to suppliers and users, their access to supplies or markets, any legal or other barriers to entry, supply and demand trends for the relevant goods and services, the interests of the intermediate and ultimate consumers, and the development of technical and economic progress provided that it is to consumers' advantage and does not form an obstacle to competition."

There is a serious question as to whether Article 2(1)(b) provides for an efficiency defence. Here, the phrase "development of technical and economic progress provided that it is to consumers' advantage and does not form an obstacle to competition" is the key. The *Merger Regulation* does not give any other guidance as to the meaning of the phrase, but the publication "Notes[115] on *Merger Regulation*" refers to how the concept is understood in other parts of the *EC Treaty*, notably Article 81 (3) – suggesting that similar interpretations may be appropriate for mergers.

Economic and technical progress is also part of the assessment of block exemptions for agreements, which would otherwise have been prohibited pursuant to Article 81 (1) of the *EC*

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[115] Notes on Council Regulation 4064/89,
http://www.europa.eu.int./comm/competition/mergers/legislation/regulation/notes.html

Treaty. Article 81 (1) prohibits agreements, which have the object or effect of preventing, restricting or distorting competition. These are typically concerted practices such as price fixing or market sharing. The exemption granted by Article 81 (3) will be given to an agreement "which contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit." This is apparently a broader set of efficiencies than that considered for mergers as it includes the phrase "improving the production or distribution of goods". Whether the Commission sees the kinds of relevant efficiencies as different in the two cases is not clear. Notice also that under Article 81(3) the agreement must not impose restrictions on the firms that are unnecessary to achieve the objectives, and must not give the firms the possibility of eliminating competition.

The Commission has published a notice on the applicability of Article 81 of the *EC Treaty* to horizontal agreements,[116] which is a guideline to establish the principles for assessment of horizontal co-operation agreements that meet the requirements under Article 81(3).[117] This may provide some guidance for the interpretation of the *Merger Regulation*. The notice defines economic and technical progress as static and dynamic efficiencies, which must be shown to stem from the co-operation agreement, and must not be attainable in a way that is less restrictive to competition. Also, efficiency claims must be substantiated, which means that general assertions about the economic benefits of the agreement are not sufficient. Claims of cost savings that arise from output reduction, market sharing, or mere exercise of market power will not be taken into account. An important criterion of the agreement is that if one of the participants to the agreement is, or becomes dominant as a consequence, and the agreement therefore prevents, distorts or restricts competition, the agreement cannot be exempted.[118]

The notice describes which kinds of efficiencies can be claimed, but the manner in which they are treated differ between agreements under Article 81(3) and the *Merger Regulation*. Under

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[116] Commission Notice: Guidelines on the applicability of Article 81 of the EC Treaty to horizontal cooperation agreements (2001/C 3/02). Published in the Official Journal C 3 of 06.01.2001, p. 2

[117] See Commission Regulations 2658/2000, the specialization block exemption Regulation and 2659/2000, the R & D block exemption Regulation.

[118] Commission Notice (2001/C 3/01), para. 36.

Article 81 (3) efficiencies are allowed to outweigh restrictive effects on competition as long as competition is not eliminated, and as long as consumers get "a fair share." Under the *Merger Regulation*, on the other hand, efficiencies must be to the "consumers' advantage". While it is certainly not obvious that this is a more difficult standard than the "fair share" standard, some commentators believe it is -- in fact that it implies that all efficiency gains must be passed on to the consumer. Whish (2001) is of this opinion, arguing that efficiencies under Article 81 (3) "can be used to 'trump' a restriction of competition, provided that the elimination of competition will not be substantial. Article 2 (1) of the *Merger Regulation* however seems to suggest that if competition would be affected at all, efficiency is not available as a trump card."[119] In our view there is another possible interpretation of the "consumers' advantage" standard that sees it more like a consumers' surplus or price standard – after all, a merger that lowers prices or raises consumers' surplus even slightly would be to the "consumers' advantage" even if it created significant new market power in the process.

In its contribution to the 1996 OECD report,[120] however, the Commission makes it clear that it (in 1996 at least) does not see any kind of efficiency defence for mergers:

> "there is no real legal possibility of justifying an efficiency defence under the *Merger Regulation*. Efficiencies are assumed for all mergers up to the limit of dominance – the 'concentration privilege'. Any efficiency issues are considered in the overall assessment to determine whether dominance has been created or strengthened and not to justify or mitigate that dominance in order to clear a concentration which would otherwise be prohibited."

In the same OECD paper[121], the Commission also sees a greater role for efficiencies in Article 81(3) cases – defining the application of an efficiency defense under 81 (3) as a 'sliding scale'. Under the sliding scale the more competition is restricted, the higher the efficiency claims must be in order to grant an exemption. This is not the case for mergers, where efficiencies are

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[119] Whish (2001), pp. 778-779.

[120] OCDE/GD(96)65 "Competition Policy and Efficiency Claims in Horizontal Agreements".

[121] OCDE/GD(96)65 "Competition Policy and Efficiency Claims in Horizontal Agreements", p. 53.

assumed up to the limit of dominance. Efficiencies in mergers cannot justify or mitigate dominance.

This suggests that, with respect to mergers, the EU has adopted two of the strategies described in chapter 1: they have set high thresholds (dominance) before they intervene to assure that most mergers and their efficiencies will not be threatened; and they incorporate efficiency issues as part of the determination of whether the merger creates or strengthens dominance.

Concern that the Commission could view efficiencies as a bad thing probably stems from the Article 2(1)(b) qualification of the benefits of the "technical and economic progress" when this efficiency "does not form an obstacle to competition". This suggests that a merger generating efficiencies that make a superior competitor but hurt rivals might be disallowed, even if consumers benefit.

Case law is very limited on the treatment of efficiencies in merger cases. Griffin & Sharp (1996) speculate that the limited case law can be due to the lack of guidance from the *Merger Regulation*, the uncertainty of the effect of an efficiencies defence when dominance is found, and the general difficulties in quantifying efficiencies. Some commentators go so far as suggesting that even if there is reference to efficiency gains by parties to a merger the Commission does not "attempt to evaluate their significance, let alone to quantify their importance."[122] Whish (2001) summarises the Commission's decisions in which efficiencies have been claimed, assigning them to three categories.

(i) the Commission determines that the merger does not create or strengthen a dominant position, and therefore considers evaluation of efficiencies is unnecessary;

(ii) the Commission renders determinations which, without much detail, dismiss the parties' efficiency claims; and

(iii) the Commission has found that efficiencies are not likely to be passed on to consumer and has not allowed the merger.

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[122] Nevens, Papandropoulous & Seabright (1998), p. 106.

Most notably, the Commission had *never* concluded, that a merger could be cleared based on efficiencies, despite the creation or strengthening of a dominant position.

In a report commissioned by the Commission,[123] Ilzkovitz and Meiklejohn (2001) express quite a harsh view of the Commission's and the *Merger Regulation*'s treatment of efficiencies, stating that the *Merger Regulation* and the case law are more consistent with an "*efficiencies offense*". First, they see significant differences due to the fact that the *Merger Regulation*, contrary to art. 81(3), only includes technical and economic progress – not improvements to production and distribution. The authors conclude that the omission of production and distribution improvements is a narrow construction of efficiencies to only include gains through innovation, which clearly are harder to measure than economies of scale. Second, the difference of the application of consumer welfare in art. 81(3) and the *Merger Regulation* makes the latter harder to interpret. In art. 81(3) a fair share must be passed on to the consumer – there is no such requirement in the *Merger Regulation*. The authors speculate that this could be interpreted in two ways. First, that any efficiency gains are sufficient (until dominance is achieved) or second, that all efficiency gains must be passed on to consumers (which would render a merger useless to the shareholders). Finally, the authors comment that requiring that technical and economic progress must not form an obstacle to competition, makes an efficiencies defense impossible, since gains in efficiency are likely to enhance the firms' market power. This is what the authors refer to as the 'efficiency offense'. *Danish Crown/Vestjyske Slagterier* is mentioned as the clearest case portraying the Commission's views:

> "As far as those efficiencies are concerned, it should be noted that under Article 2(1)(b) of the Merger Regulation the Commission may take account of the development of technical and economic progress only to the extent that it is to consumers' advantage and does not form an obstacle to competition. The creation of a dominant position in the relevant markets identified above, therefore, means that the efficiencies argument put forward by the parties cannot be taken into account in the assessment of the present merger."[124]

Other commentators define the 'efficiency offense' as stemming from Commission decisions which appear to view efficiencies as amplifying the finding of a dominant position. That is,

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[123] Ilzkovitz & Meiklejohn (2001), pp. 13-15.

[124] Commission Decision 2000/42/EC of 9 March 1999 (OJ L 20, 25.1.2000).

efficiencies can be viewed as giving the merged firm an advantage over other firms in the market, which could allow the merged firm to abuse that position.[125] Although efficiencies were dismissed as being insignificant in *de Havilland*[126] (see also below), the Commission concluded that efficiencies along with a dominant position would likely result in the merged firm adopting a predatory pricing strategy to force the remaining competitors off the market.

Ilzkovitz and Meiklejohn's views are stronger than most other commentators on this topic, but illustrate the range of opinions on these questions. At the other end of the spectrum, Commissioner Monti, while implicitly agreeing that no efficiency defence exists, disagrees with the suggestion that there is an "efficiencies offense":

> "Many respondents consider that the Commission should, as part of a sound economics-based merger control policy, take efficiencies into account in conducting its analysis of the overall effects likely to be produced by a proposed merger. In other words, they consider that there should be an "efficiency defence" that could mitigate a finding of dominance. I share this approach... I have said this before, but let me clarify it once and for all: there is no such thing as a so-called "efficiency offence" in EU merger control law and practice."[127]

3.5 The Methodology and Welfare Standard Employed

In the EU, claimed efficiencies must be to the consumers' advantage, pursuant to Article 2 (1)(b). However, it is uncertain whether this means that all progress must be passed onto the consumers in a lower price, or whether it means that price cannot rise due to the merger. As will be shown below, in the EU case law, it does not appear that claiming efficiencies can be considered a defence for a merger that hinders competition. Even if progress were to be passed on to consumers, it is highly unlikely that a merger that creates or strengthens a dominant position would be allowed based on claimed efficiencies. This approach is consistent with the *consumers' surplus standard* or the *price standard* as defined in Chapter 1 above.

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[125] Frédéric Jenny (a member of the French Competition Council) expressed the view that "not only is there no 'efficiency defense' in EEC Merger Regulation, but...there can be cases of 'efficiency attack'". Jenny (1992) p. 597.

[126] Aerospatiale-Alenia/de Havilland, Commission Decision 91/619/EEC of October 2nd 1991.

[127] Monti (2002) in speech at the conference on Reform of European Merger Control.

3.6 Efficiencies Gains and Consumers

From the case law it appears that claims of efficiencies must benefit the consumer, either through lower prices, increased product choice or improved product quality.

It is said directly in the *Merger Regulation* art. 2(1)(b) that technical and economic progress must be to the consumers' advantage, and in cases the Commission has looked for evidence that consumers will benefit. In *de Havilland*[128] the Commission found the claimed efficiencies to be insubstantial (0.5%), and found that even if such gains existed, it was not proved that it would be to the consumers' benefit. Rather, the gains in efficiencies could help strengthen a dominant position. De Havilland concerned Aerospatiale's (a French company) and Alenia's (an Italian company) joint acquisition of de Havilland. Aerospatiale and Alenia together were the world's largest regional aircraft manufacturer, and de Havilland, the second largest. The acquisition would have given the merged firm a world market share of 50%, with the nearest competitor holding only a 19% share. The Commission also concluded that the merger would significantly reduce the consumer's choice of products on the market. The merger was blocked, and created a lot of discussion regarding the Commission's market definition, which some thought was too narrow.

Accor/Wagon-Lits[129] concerned the merger of freeway restaurant services. The efficiencies claimed were related to improved training of personnel and modernization, which the Commission found were insufficiently proven. Efficiencies would also have been insufficient to overcome any anticompetitive concerns, and due to inelasticity of demand of the services, the benefits would not likely have been passed on to consumers. The merger was ultimately allowed subject to undertakings.

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[128] Aerospatiale-Alenia/de Havilland, Commission Decision 91/619/EEC of October 2nd 1991.

[129] Case No. IV/M.126, 1992 O.J.. (L2041) 1; 5 C.M.L.R. M13 (1993).

3.7 Merger Specificity and Attainability in a Less Anti-competitive Manner

It appears that the EU clearly demands that efficiencies be merger specific, and that they not be attainable in a less anti-competitive manner.

In *de Havilland*[130] the claimed efficiencies were not considered to be merger specific, and the Commission concluded that they would be attainable through other means.

Nordic Satellite Distribution[131] concerned a joint venture for the distribution of satellite television to the Nordic area. The joint venture was prohibited although it created significant efficiencies. It was decided that the efficiencies could be achieved in a less anti-competitive manner.

Mercedes-Benz/Kassbohrer[132] was a merger between bus manufacturers, which ultimately was allowed conditional on certain undertakings. The Commission briefly rejected efficiencies, because it was not sufficiently proven that they were a result of the merger.

3.8 Whether Gains in Efficiencies can "Justify/Offset" the Elimination or Near Elimination of Competition

Gains in efficiencies cannot justify or offset the elimination of effective competition. Dominance is the upper limit on limits to competition. If dominance is the consequence of a merger, the merger will not be allowed, regardless of any efficiencies. In *MSG Media Service*[133] an efficiency claim was rejected because the joint venture would create a dominant position. The joint venture merged three large German companies providing digital pay television. The Commission stated that regardless of contributions to technical and economic progress, no obstacle must be formed to competition.

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[130] Aerospatiale-Alenia/de Havilland, Commission Decision 91/619/EEC of October 2nd 1991.

[131] Case No. IV/M.490, 5 C.M.L.R. 258 (1995).

[132] Case IV/M.477 (Feb. 14, 1995), [1995] O.J. L211/1.

[133] Case No IV/M.469 – MSG Media Service, para. 100-101.

In many cases, where the Commission denies the merger due to a creation of dominance, the issue of efficiencies are never raised, or at least never reported in the case summaries.

3.9 Policy Statements or Guidelines on the Treatment of Gains in Efficiency in the Review of Mergers

The Green Paper on the *Merger Regulation* of 11.12.2001 opens up a discussion of review of efficiencies claims in the *Merger Regulation*. The Commission, as noted above, acknowledges the lack of emphasis on efficiencies in merger cases so far, and that the "*precise scope for taking such consideration into account may not have been fully developed.*"[134] The Commission supports ongoing debate on how, and to which extent, efficiencies should be incorporated into EU competition policy, but it seems rather unlikely that there will be any decisions in this regards in the near future. In the same report the Commission discusses the implications of switching from the dominance test to a substantial lessening of competition test, as it is used in Canada, the United States and Australia. One argument for changing to a substantial lessening of competition test is the rise in mergers that affects multiple jurisdictions around the world, and calls for closer co-operation between competition authorities. Using the same test would make the co-operation easier.[135]

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[134] Green Paper on the Review of Council Regulation (EEC) No 4064/89, Brussels, 11.12.2001, COM(2001) 745/6 final, para. 170.

[135] Green Paper on the Review of Council Regulation (EEC) No 4064/89, Brussels, 11.12.2001, COM(2001) 745/6 final, para. 159-169.

4 United Kingdom

4.1 General Background

Merger control came to UK competition policy in the *Monopolies and Mergers Act* of 1965 but the merger review system continues to go through a period of change at the present time. With the *Competition Act 1998*, the UK is supposedly bound to the EU competition principles, although the 1998 Act does not include provisions for mergers, which are therefore still covered by the *Fair Trading Act 1973*.[136] The White Paper published in July 2001 indicated that the UK is headed toward the enactment of a new competition law, which is going to thoroughly change the system that is now in place.[137] Among the proposed changes, the most significant involve removing Ministers from decision making except in the exceptional cases of public interest; changing the merger test from the current *public interest* test to the *substantial lessening of competition test;* allowing anti-competitive mergers to proceed when they bring overall consumer benefits, and improving transparency in the merger process.

4.2 Merger Review Process

The relevant provision in the *Fair Trading Act* (the Act) in determining whether or not to allow a merger is Section 73, which states that the Secretary of State for Trade and Industry (the Secretary of State) is empowered to take action to remedy or prevent any adverse effects of a merger if "it is found that it operates or may be expected to operate against the public interest." In determining whether the merger operates, or may be expected to operate, against the public interest, Section 84 states that "the Commission shall take into account all matters which appear to them in the particular circumstances to be relevant", and gives a non-exclusive list of matters which must be considered – a list which includes competition issues as well as social considerations. In general, 'public interest' is a very wide concept.

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[136] See appendix C for relevant provisions of the Act.

[137] Department of Trade and Industry: "A world Class Competition Regime", July 2001.

Section 84(1) of the *Act* provides some guidance regarding how "public interest" is to be interpreted. It indicates that the CC shall take into account "all matters which appear to them in the particular circumstances to be relevant" having regard, among other things, to the desirability of:

(a) maintaining and promoting effective competition in the United Kingdom;
(b) promoting the interests of consumers, purchasers and other users in the United Kingdom;
(c) promoting, through competition, the reduction of costs and the development and use of new techniques and new products, and of facilitating the entry of new competitors into existing markets;
(d) maintaining and promoting the balanced distribution of industry and employment in the United Kingdom; and
(e) maintaining and promoting competitive activity in markets outside the United Kingdom, on the part of producers and suppliers of goods and services in the United Kingdom.

While these goals go well beyond simply the protection of competition, recent governments have tended to consider most seriously the factors that do involve the enhancement of competition and less seriously the other factors. And this is definitely the direction the government indicates it intends to take with the upcoming reforms.[138]

It is important to note the different role played by this "public interest" test and that played by the "public benefits" test in Australia. In the U.K. system, the public interest test in the entire test of the desirability of a merger – there is no other SLC or dominance test, save the rather limited conditions imposed by the assets or market share thresholds described below. The Australian public benefits test, in contrast, is part of the authorization process which would – in principle at least – only come into play if there was concern that the merger would substantially lessen competition in a market. The implication of this difference is that a merger in the U.K. could be blocked (again, in principle) when it had no effect on competition, if it was found to offend other aspects of the public interest.

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[138] See, e.g. Rowley and Baker (2001, p. 63-9).

The investigation of mergers and acquisitions in the UK is currently a process involving three separate entities. The Office of Fair Trading (OFT) (headed by a Director General), The Competition Commission (CC) (formerly the Monopolies and Mergers Commission,), and the Secretary of State for the Department of Trade and Industry. The CC is a department under the Secretary of State, and must follow the policies laid out by the Secretary. The process is by nature almost completely administrative, with essentially no role for courts.

The OFT is responsible for monitoring the UK market for mergers and acquisitions, for which notification is not required. When the OFT finds that a merger might operate against the public interest it will advise the Secretary of State. If the merger qualifies, the Secretary of State has discretion in deciding whether or not to make a reference of the case to the CC for investigation, although in October 2000 the Secretary of State announced that he will follow the advice of the OFT except in exceptional cases of national security.[139] The Secretary of State may also refer cases on his own, without the recommendation of the OFT.

In order to be a qualifying merger, two or more enterprises must "cease to be distinct" and the merger must satisfy either the "assets" tests or the "market share" test. To satisfy the assets test, the value of the gross assets acquired must exceed £70 million. To satisfy the market share test, the combined firm must "together supply or receive at least one-quarter of the goods or services of a particular description supplied in the United Kingdom or a substantial part of it". We do not think it is appropriate to consider these as anything like an SLC test, rather they are simply screens that allow for the exclusion of many small mergers that can have little or no effect on the public interest.

Upon receiving the case, the CC conducts a thorough investigation of the merger, and sends its advice on the matter to the Secretary of State, who again has discretion on whether or not to allow the merger. The Secretary of State has to power to block the merger, to require divestiture

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[139] Whish (2001), p. 813.

if it has already been completed, or to permit the merger to proceed subject to appropriate safeguards. The Secretary of State cannot block the merger if the CC has not objected to it. [140]

Although there are no statutory notification requirements, parties to mergers will often notify the OFT. There are two different ways of notifying a merger. The first notification process is the 'statutory voluntary' notification.[141] The Statutory process provides for strict timelines within which the OFT and the Secretary of State have to render a decision of whether or not to refer the merger to the CC. If a decision has not been rendered with 35 days, the merger is automatically cleared. The statutory voluntary notification is only available when the proposed merger has been made public, and the prescribed Merger Notice form must be used.

The second notification process, and the most popular with merging firms, is the 'informal voluntary' notification, which the OFT considers equally acceptable as the statutory process. A decision on whether or not to make a reference to the CC is usually given within 45 days, and the parties need not follow a prescribed form.

The OFT also makes available confidential guidance, as long as the proposed merger has not been made public, but does not make binding decisions on whether or not to recommend a proposed merger be referred to the CC. If new information becomes available when the merger is made public, the OFT and the Secretary of State may change their decisions.[142]

If a merger is made public without prior notification to the OFT, the OFT has four months from the date of publication to decide whether or not to launch an investigation. There are no ramifications for the parties involved for not notifying the merger if the CC ultimately decides that the merger operates against public interest, but the parties to the merger can potentially be ordered to reverse an already executed transaction.[143]

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[140] Gardner (2000), White Paper (2001), Rowley & Baker (2001)

[141] Merger Guide, OFT, para. 5.5. and Whish (2001), p. 811.

[142] Merger Guide, OFT, para. 5.10.

[143] Whish (2001), p.809.

This indicates a very administrative and potentially political process since the Secretary of State has the last word in all cases. Furthermore, the access to appeals on decisions is very limited. It would appear that appeals must be based purely on the point of law as the House of Lords instructed in *Lonrho*[144]:

> "the courts must be careful not to invade the political field and substitute their own judgement for that of the Minister"[145]
>
> and that action taken under the Act: "could be very much a political question. All decisions were to be made by the Secretary of State. That was what would be expected in a field as politically charged and as important to the economy as competition policy."[146]

Commentators state that it can be very difficult to derive the policy and reasoning behind decisions because of this administrative – and, at times, political -- process. Over the past few years the process has become more open, and the CC now publishes all recommendations made to the Secretary of State. But concerns about the politicization of competition policy remain. As Wilks (1999) reports, the UK "approach has rested ultimately on the operation of ministerial discretion, a phenomenon that cannot be analysed other than with political tools."[147]

The OFT has published a Merger Guide that explains its approach to investigating mergers. It defines its role as:

> "The judgment that has to be made is whether the merger would give rise to a degree of market power that would allow the merged company to raise prices or reduce quality to the detriment of its customers or to operate in some other way that could be against the public interest."[148]

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[144] R. v. Secretary of State for Trade and Industry, ex p. *Lonrho [1989]* 1 W.L.R. 525, regarding Lonrho's complaint that the Secretary of State had not referred Fayed's acquisition of House of Fraser to the Commission for review. Lonrho had also wanted to acquire House of Fraser.

[145] Rowley and Baker (2001) p.63-5.

[146] Rowley and Baker (2001), p. 64-34.

[147] Wilks (1999), p. 156.

[148] Merger Guide, OFT, para. 4.6.

The OFT categorizes efficiencies as part of the public interest issues that can be evaluated, and states that although it encourages claims of efficiencies, the OFT will "not closely involve itself in evaluating claims for gains in efficiency".[149] Rather, "any judgment that needs to be made about the trade-off between efficiency claims and the potential detriment to competition is usually better left until after a more detailed investigation by the Competition Commission." The OFT also considers a mergers effect on employment and regional development as part of the public interest considerations.

The CC has not published any guidelines expressing its views on the definition of efficiencies.

4.3 Reform Forthcoming

As mentioned above, in July 2001, the Secretary of State for Trade and Industry published a White Paper, which promises to lead to significant changes to the merger regime.[150] As of this writing, no new legislation has yet been passed, but since the beginning of the discussions on reform in 1999 the Minister has begun to operate by some of the principles of the new system. Most notably, abiding the recommendations of the Commission and the OFT, so as to remove any political overtones from decisions.[151] It is expected that the new merger regime will work as follows:

- Final decisions on most mergers will be taken by independent competition authorities rather than Ministers.
- The test they will apply will be to determine whether the merger results in a substantial lessening of competition rather than the current public interest test.
- Exceptionally, where competition considerations point the other way, it will be possible for the authorities to clear a merger or allow it to proceed with less stringent competition remedies where they believe it will bring overall consumer benefits.
- The Secretary of State for Trade and Industry will continue to decide the small minority of mergers which raise defined exceptional public interest issues.
- National security will be defined at the outset as an exceptional public interest issue. It will be possible to define further exceptional public interest issues by statutory instruments.
- The new regime will retain a two-stage approach to merger investigations. The OFT will carry out first stage investigations which will be sufficient to decide most cases. The

[149] Merger Guide, OFT, para. 6.17.

[150] White Paper (2001).

[151] Rowley & Baker (2001).

Competition Commission will continue to carry out second stage, in-depth investigations where necessary.

- There will be statutory maximum timetables for both first and second stage investigations by the competition authorities. There will also continue to be the option of an administrative timetable at stage one.
- The criteria used to determine which mergers qualify for investigation will be modernized to focus more efficiently on cases that may raise concerns.
- The UK's system of voluntary rather than compulsory pre-notification of mergers will be retained.[152]

The White Paper lays describes a substantial lessening of competition test that encompasses those situations where, although competition has been lessened as a result of the merger, it may nonetheless produce overall benefits to the consumers and therefore be permissible. Consumer benefits are lower prices, or greater innovation, choice, quality of products or services. The benefits must be expected to materialize within reasonable time, and be unlikely to be realized without the merger. Consumers are typically end-consumers, but can also encompass consumers in upstream markets, where the immediate beneficiaries of a merger are other businesses.[153]

4.4 Historical Context and Evolution of the Role of Efficiencies

Historical information on the treatment of efficiencies in mergers is scarce. As seen from the description of the merger review process above, the process has, until recently, been highly political. The wide definition of public interest, under which efficiencies belong, makes deriving a definite conclusions on the treatment of efficiencies very difficult. A few points will be made here.

Wilks (1999) lists six principles that have been paramount since the first Fair Trade Act was enacted in 1965 containing merger legislation:

- Mergers are regarded with favor
- Merger control is administrative, not judicial
- The American model of prohibition is rejected
- The economic impact of mergers is subject to a 'monopoly' test
- The procedures and the ultimate criteria are politically controlled

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[152] White Paper (2001), p. 24, box 5.1.

[153] White Paper (2001), p. 25.

- The main discipline is business self-regulation[154]

In a 1988 White Paper, the laissez-faire policy of the competition authorities was reinforced, by stating that 'the market will be a better arbiter than Government of the prospects for the proposed transaction, and will ensure better use of assets, for the benefit of their owners and the economy as a whole.'

According to Gardner (2000), UK practice is "to permit a merger to proceed, even if it leads to a substantial increase in market power, unless there is convincing evidence that it will be against the public interest."[155] He also states that efficiency must be sought through competition, but that objective of public interest must be balanced against a number of others.

It appears as though the policy starts to turn more consumer-oriented in the 1990's, and a clearer picture of the principles used arise. The impact on competition is more important today than other policy objectives that the sitting Government might have. The current Secretary of State has already, before legislation is in place releasing her from the final say in mergers, kept out of such decisions for the most part. In the following chapters decisions by the CC will illustrate the treatment of efficiencies in the public interest test as far as it is possible.

4.5 Definition and Treatment of Efficiencies

Mergers in the UK are assessed under the public interest criteria, which involves "all matters which appear to them in the particular circumstances to be relevant", pursuant to s. 84 of the *Act*,[156] which also specifies the five areas that must be considered in this regard. S. 84 leaves, as noted above, the assessment of mergers open to a wide range of factors that can be considered. Since it is the Secretary of State that has the ultimate power to allow or prohibit a merger, with no requirements to explain his decision, it is essentially the policy of the particular Secretary of State that matters in the current review system.

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[154] Wilks (1999), p. 205.

[155] Gardner (2000), p. 76.

[156] See Appendix C for the full text of s. 84.

Nevertheless, cases are referenced and summarized by the CC with explanation of the conclusions made, and some general rules on the consideration of efficiencies can be derived. Röller et al. (2000) upon reviewing the cases, indicate that for efficiencies to be decisive in the UK, they have to be significantly large, merger-specific and passed on to consumers.[157] The OFT Merger Guide does not give any definitions or guidance as to which types of efficiencies could be accepted, how to calculate them, or how to weigh them against anti-competitive effects. Correspondingly, the CC has not published guidelines that would clarify its view of efficiencies.

In *General Utilities*,[158] the benefits arising from the merger (which concerned General Utilities' ability to materially influence the policy of Mid Kent Water with a 30% share of the capital) were not considered 'of substantially greater significance in relation to the public interest...', and would not outweigh any detriment. Among the benefits was the development of complementary business activities. The merger concerned water companies, which are also regulated by the Water Act. The merger was eventually approved on the condition of certain undertakings.

It would appear that gains in efficiencies must be passed on to consumers if competition has been lessened substantially. In *Rockwool*,[159] the Commission accepted that there would be significant efficiency gains flowing from the merger as well as a bettering of the environment, but the efficiency gains, although significant, were not considered to be large enough to outweigh the damage to competition and the merger was rejected. Rockwool, with a market share of 78%, was to buy Owens, with a market share of 18%, a rockwool manufacturing plant. It was clear that if the merger was blocked, the plant would be sold to another buyer (if one could be found), or alternatively closed, and in both alternatives the likely efficiency gains would be less than if Rockwool acquired the plant. The employment effects of all alternatives were considered alongside efficiencies, environmental issues and public benefits in general. With regards to consumers the Commission said:

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[157] Röller et al. (2000), p. 80.

[158] *General Utilities plc/The Mid Kent Water Company*, 4.7.1990.

[159] *Rockwool Limited and Owens-Corning Building Products (UK) Limited*: A report on the proposed merger, 07.05.99

> 2.152. We have no doubt that Rockwool would raise the efficiency of the Queensferry plant if the merger proceeded. We do not expect the benefits to be passed on to customers in lower prices: Rockwool's business plan indicates that it expected to retain the benefits of the cost savings, as well as the price increases.

An older case had suggested somewhat less concern about seeing consumers derive positive benefits from the merger. In *Scottish & Newcastle/Matthew Brown* (1985)[160] it was concluded that:

> "we discern no material advantages to the public interest arising from the proposed merger; but the question before us is whether the merger may be expected to operate against the public interest, and in our view there are not sufficient grounds for such an expectation."

It appears that efficiencies claimed must not be attainable in a less anticompetitive manner. In *Capital Radio*[161], which concerned a merger between commercial radio stations, the claimed efficiencies stemming from better management and financial strength were considered attainable in the absence of the merger. Certain cost savings stemming from moving Virgin Radio to Capitol's studios were insignificant. Also, prices were expected to rise higher than in the absence of the merger. The merger was subsequently abandoned by the parties.

We expect that the new merger regime will require that efficiencies must be merger specific. Also, as mentioned above the new merger regime states that, in order for to efficiencies to apply in a defense of a merger that substantially lessens competition, they must be unlikely to occur in absence of the merger.

In the past, some mergers have been cleared based on efficiencies despite evidence that there could be a substantial effect on competition. This may become more difficult, as it appears that the new merger system will allow some lessening of competition, but only if there is proof that benefits to the consumers are expected to materialize within a reasonable timeframe. Whish (2001) states that although efficiency claims are heard, the CC most likely will be reluctant to allow a merger that is otherwise detrimental to competition.

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[160] *Scottish & Newcastle/Matthew Brown (1985)*, para. 7.13. See Gardner (2000) p. 76

[161] *Capital Radio Plc and Virgin Radio Holdings Limited*: A report on the proposed acquisition, para. 2.123.

Earlier cases suggested a greater tolerance of mergers in concentrated markets. In *Stagecoach*,[162] the Commission accepted 'several benefits' including increased efficiency in operations, improved fleet and quality of service and a more innovative approach in developing the market. Stagecoach acquired Chesterfield, another bus operator bringing the combined market share to 63%. It was considered unlikely that Chesterfield, or any other potential acquirer, could achieve the expected gains in efficiency in absence of the merger. Also important perhaps too, however, was the fact that there were concerns that Chesterfield could not continue as an independent operator.

In *Swedish Match/Alleghany*[163] the merger was allowed despite an already highly concentrated market, in part because of a declining market, stating:

> "this is a merger which would lead to a substantial degree of additional concentration in an already highly concentrated market. We believe, however that, in the exceptional circumstances of the declining market which we have described, it is unlikely that a merged Bryant & May/Masters would raise prices unreasonably, or materially reduce the number of brands available, or the standards of service to customers."

It later turned out that the Competition Commission (then the Mergers and Monopolies Commission) was mistaken -- prices rose dramatically, and price controls were recommended to control profits.[164] The case exemplifies that mergers in highly concentrated markets have been allowed in the past, based upon efficiencies or public interest claims.

In *Alanod Aluminium*[165] the CC accepted that the merger had created opportunities for cost savings and that it had contributed to the security of production and employment in the town of Milton Keynes, but did not believe that these benefits were sufficient to balance the detriments to competition. The merger resulted in Alanod having a 75% market share in the market for anodised aluminium coil, and CC concluded that the firm would have substantial market power.

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[162] *Stagecoach Holdings plc/Chesterfield Transport (1989) Limited*, 18.1.96. Summary account from Competition Commisson, full text not available.

[163] *Swedish Match/Alleghany*, Cm 227, 21.10.87

[164] Gardner (2000).

[165] *Alanod Aluminium-Veredlung GmbH & Co/Metalloxyd Ano-Coil Ltd*, Cm 4545 (2000)

However because the merger had already been completed, it was permitted subject to remedies, including a price cap.

If there are concerns that a merger will reduce efficiency, this can be seen to operate against the public interest. A reduction in efficiency was one of the reasons for concluding that the merger between two pharmaceutical information businesses was considered to operate against public interest in *IMS Health.*[166] IMS was already dominant in the market, but the merger was nevertheless allowed subject to behavioral and structural remedies.

4.6 Efficiencies in other Competitive Restraints

With the enactment of the Competition Law of 1998 the UK has adopted the EU's Articles 81 and 82, and will treat all cases pertaining to agreements that restrict competition and cases on abuse of dominance according to the principles of the *EC Treaty* and the Court of Justice decisions.

In chapter 3 on the EU, the treatment of efficiency claims in Article 81 (3) cases was described, and we will not repeat all of that discussion here. Significantly, the test is not a public interest test. Article 81 of the *EC Treaty* prohibits agreements between firms that might prevent, restrict or distort competition, these agreements being possibly horizontal (but not mergers) or vertical. Article 81(3), provides an exemption if the agreement "contributes to improving the production or distribution of goods, or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit."

[166] IMS Health Inc./Pharmaceutical Marketing Inc Cm 4261, 2001.

5 United States

Antitrust enforcement, including the review of mergers, is a complex business in the United States. Mergers may be held illegal under section 7 of the *Clayton Act* of 1914 (amended in 1950) where they may substantially lessen competition. In addition, notification of mergers is required under the *Hart-Scott-Rodino Act of 1976* (HSR Act). What makes the US system particularly complex is that mergers can be challenged by a number of different parties: either of the two separate federal agencies -- the Antitrust Division of the Department of Justice (DOJ) and the Federal Trade Commission (FTC) -- state attorneys-general or affected private parties. Jurisprudence is also complicated by the fact that most adjudication is done by courts of various levels and from various districts which do not always share common views.

As a result, the U.S. system consists of a variety of case law from courts at all levels, in both matters prosecuted by the DOJ or FTC, but also in private matters, where damages can be substantial (treble damages). It is not uncommon for mergers that have not been challenged by the FTC or DOJ to be challenged by private plaintiffs or a state attorney-general, if the mergers are perceived to have local impact.[167] This section will focus primarily on the cases handled by the DOJ and the FTC, and their guidelines.

5.1 Merger Review Process

Mergers are subject to review under section 7 of the *Clayton Act*, which provides that mergers and acquisitions will not be permitted where the effect "may be substantially to lessen competition, or to tend to create a monopoly".[168]

Notification is, as mentioned above, required under section 7A of the *Clayton Act* as amended by the *HSR Act*, when the acquiring person would hold an aggregate total amount of voting securities and assets of the acquired person in excess of $50 million. One of the parties must

[167] Rowley & Baker (2000), p. 64-4 and 64-38.

[168] See appendix D for the full text of Section 7 of the Clayton Act.

generally be engaged in interstate or foreign commerce in the U.S. Other thresholds apply when involving foreign firms acquiring US securities or assets.

Notification must be provided to both the DOJ and the FTC, who then between themselves decide which should have jurisdiction. After notification, the merger goes into a 30-day waiting period in which time the deal cannot be closed. If the agencies feel the need to further investigate the matter a second waiting period, also 30 days, is possible in which the agencies can request more information and documentation. When the waiting periods come to an end the parties are free to consummate the merger, although the agencies can warn the parties if a post-closing suit is likely.[169] The second request for information usually involves an enormous amount of information, which is why the 30-day period does not begin until all requested information is in the hands of the agency. This can hold up the process for long periods of time, and most mergers are cleared before the second request period.

If the investigating agency concludes that the merger is likely to substantially lessen competition, an injunction will be sought from the courts. For the DOJ, the appropriate court is the United States District Court, and for the FTC the appropriate court is a federal court. The injunction, if granted, will stop the merger from going ahead, until appropriate remedies or divestitures have been negotiated, or the agency has filed a suit to prohibit the merger. As soon as the merger has entered the courts, any agreements between the parties and the agency must be approved by the courts. In 2000, out of almost 5000 notifications to the DOJ and FTC only 87 went into the second request period, about half of those mergers were abandoned, and most of the rest were settled by consent decree.

5.2 Historical Context and Evolution of the Role of Efficiencies[170]

The role of efficiencies in merger cases has evolved tremendously over the last four decades in the United States. There is no statutory efficiency defense in American competition law, but

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[169] Rowley & Baker (2001), p. 64-46.

[170] The section on evolution of efficiencies in merger cases is based primarily on Kolasky and Dick (2002). The paper was presented at the celebration of the 20th anniversary of the 1982 US Merger Guidelines.

efficiencies have been analyzed in case law and discussed the Horizontal Merger Guidelines (the Guidelines). Recall that the competition test used in the US is the substantial lessening of competition test (or a tendency to monopolize) pursuant to section 7 of the *Clayton Act*.

Röller et al. (2000) cite two important cases as providing early Supreme Court precedents concerning efficiencies. In the infamous *Brown Shoe Co* (1962)[171] case, efficiencies were viewed as contributing to the competition problem, and the court blocked the merger despite very low market shares. The Court concluded that the goal of promoting competition was best achieved by sustaining small, locally owned businesses, rather than allowing larger firms with lower costs.

Then, in *Procter & Gamble* (1967)[172] in an often-quoted discussion, the Court said:

> "Possible economies cannot be used as a defense to illegality. Congress was aware that some mergers which lessen competition may also result in economies, but it struck the balance in favor of protecting competition."

Commentators disagree as to the conclusion to be drawn. Some interpret the decision to block the acquisition as a complete rejection of an efficiency defense when competition is lessened substantially. Others interpret the Supreme Court's rejection of efficiencies as based upon the merits of the efficiencies claimed – the mere possibility of efficiencies is not sufficient to qualify as an efficiency defense.[173] Kolasky and Dick (2002) view this case to be an example of an efficiency offense.[174]

However, the Supreme Court later, in a private action, ruled that a merger cannot be prohibited merely because it creates efficiencies that might help increase the merged firm's market share, but hurt other competitors.[175] The court concluded that even if the merged firm was dominant, it was in the interest of competition to have the firm engage in vigorous price competition. This conclusion is in contrast to many of the EU Commission's decisions, in which a merger to

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[171] *Brown Shoe Co. v. U.S.*, 370 U.S. 294 (1962)

[172] *FTC v. Procter & Gamble Co.* 386 U.S. 568 (1967)

[173] See also *U.S. v. Philadelphia National Bank*, 374 U.S. 321 (1963) for the same conclusion.

[174] Kolasky and Dick (2002), p. 6. See also Areeda et al. (1998).

[175] Cargill, Inc. v. Monfort of Colorado, Inc. 479 U.S. 104 (1986)

dominance might be prohibited if the dominance enables the firm to lower prices, and possibly engage in predatory prices to force competitors out of the market.[176] Röller et al. (2000) conclude that, while efficiencies were discussed in these American cases, an efficiency defense was never directly claimed by any parties. For this reason, the authors minimize the importance of the early Supreme Court precedents regarding the efficiency defense.

In 1968, shortly after these cases, the DOJ released the first Merger Guidelines,[177] which included a short paragraph on efficiencies in which we find:

> 10. Economies. Unless there are exceptional circumstances, the Department will not accept as a justification for an acquisition normally subject to challenge under its horizontal merger standards the claim that the merger will produce economies.

This was an important step towards breaking the courts' hostile approach to efficiencies, although it would still take some years before courts would treat efficiencies in merger cases more positively. Maybe this is not that surprising given that the 1968 Guidelines limited the use of efficiencies arguments to the very rare cases.

Two merger cases in the 1970's, which made the merger review process less structural, would thereby open up the possibilities for an efficiency defense. In *General Dynamics*[178] the Supreme Court concluded that factors other than market share affect competition in a market, indicating that factors such as efficiencies (as well as barriers to entry and other factors) can have important effects. In *International Harvester*,[179] the acquiring firm's lower cost of capital combined with a pooling of technology would allow the merged entity to better compete in the market. Previous to the acquisition the acquired firm had been at a competitive disadvantage (despite its superior technology) because of its higher cost of capital.

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[176] See the chapter on EU merger review above.

[177] U.S. Dep't Of Justice, Merger Guidelines (1968). Efficiencies are mentioned in §10.

[178] *U.S. v. General Dynamics Co.*, 415 U.S. 486 (1974). General Dynamics acquired Material Services, in the process becoming the nation's sixth largest coal producer and the largest producer in the Midwest.

[179] *U.S. v. International Harvester Co.*, 564 F.2d 769 (7th Cir. 1977).

In this period of time, some non-merger cases were won based on efficiency, opening up the possibility for an efficiency defense in mergers in 1980's. For example, in 1977 the Supreme Court allowed the vertical restrictions Sylvania imposed on its distributors, recognizing (and in the process overruling its *Schwinn* decision) that the restrictions improved the ability of the manufacturer to secure efficient distribution.[180] Then, in the *Broadcast Music* case in 1979, the Court recognized that some agreements limiting competition between rival firms could be efficient, if they help the firms provide some new product or service.[181]

The 1982 Merger Guidelines did not change the paragraph on efficiencies very much. Efficiencies would only be considered in "extraordinary cases".[182] In order for efficiencies to be considered, they must be clear and convincing, substantial, realized by other firms in the industry and not attainable in a less anti-competitive manner.[183] At the same time, the FTC issued a statement that it would consider "measurable operating efficiencies" in its prenotification examinations, where there was substantial evidence that the cost savings would clearly outweigh the increase in market power.

Only two years later, the DOJ revised the 1982 Guidelines with rather significant changes relating to efficiencies. The 1984 Merger Guidelines moved efficiencies from a defense to the competitive effects section, with the result that efficiencies became part of the analysis of whether a merger lessens competition substantially. The cost savings are still not to be explicitly balanced against the anti-competitive effects however. Efficiencies would be considered if they are clear and convincing and the merger is reasonably necessary to achieve the savings. In addition, the efficiencies must be significant and they must be greater than the expected competitive risks. This was a definite change in policy away from the more Chicago-oriented theory to the more efficiency sensitive Harvard school of thought. Although the FTC did not

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[180] *Continental TV Inc. v. GTE Sylvania Inc.* 433 U.S. 36 (1977), *United States v. Arnold Schwinn & Company*, 388 U.S. 365 (1967).

[181] *Broadcast Music, Inc. v. Columbia Broadcasting System, Inc.* 441 U.S. 1 (1979).

[182] U.S. dep't. of Justice, Merger Guidelines (1982) § 10.A.

[183] Kolasky and Dick (2002), p. 16.

change its guidelines along with the DOJ, they, nevertheless, did follow in the change of policy and the acceptance of efficiency claims in mergers grew.

Courts seemed prepared to give more attention to efficiencies as well. In *University Health*[184] it was concluded that merging parties may use efficiencies to rebut the governments *prima-facie* case:

> "We conclude that in certain circumstances, a defendant may rebut the government's prima facie case with evidence showing that the intended merger would create significant efficiencies in the relevant market."

The case concerned a merger between two non-profit hospitals. The Court concluded that the parties had failed to present sufficient evidence of how efficiencies would be created and maintained, and denied the merger. The Court did indicate that the efficiencies must benefit competition and consumers.

In 1992, the FTC and DOJ joined forces and issued the first joint Guidelines. The efficiencies section was left pretty much unchanged with one important exception – the sentence that indicated that the agency would not consider efficiencies unless they were "established by clear and convincing evidence" was dropped. As a result, the standard of proof was lowered, and efficiency arguments were to be more easily made.

5.3 Definition and Measurement of Gains in Efficiency

In 1997 the Guidelines were amended with the addition of a separate chapter on efficiencies. They came about in part because of concern the agencies were not giving efficiencies adequate respect. An FTC staff report, prepared after a series of hearings held in 1995 and 1996, had endorsed a more complete integration of efficiencies into the competitive effects analysis in

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[184] *FTC v. University Health, Inc.* 938 F.2d 1206 (11th Cir. 1991).

merger cases.[185] The agencies claimed that the changes to the Guidelines made in 1997 did not represent a policy change, but rather a more complete explanation of the agencies' treatment of efficiency claims. The agencies will consider efficiencies under the following conditions:

- Efficiencies must be merger specific, meaning that they must be unlikely accomplished in the absence of either the proposed merger or another means having comparable anticompetitive effects. Only alternatives that are practically attainable in the business situation faced by the firm will be considered.
- Efficiencies must be substantiated in order to be verified by the agencies. The verification goes to the likelihood and magnitude of the efficiencies.
- The timeline for achieving the efficiencies must be verified, along with an explanation of how the proposed efficiencies would enhance the merged entity's ability and incentive to compete.
- Efficiencies must be calculated by subtracting any cost of merging and of achieving the said efficiencies.
- Cost savings that are attributable to a reduction in output or services will not be considered.

The type of efficiency claimed might have an influence on the outcome of the case. The Guidelines specify that cost savings that actually decrease marginal cost are more likely to be cognizable and substantial. It is not required that efficiencies be quantified in all circumstances. Additionally, it is accepted that although R&D cost reductions might be substantial, they are less likely to qualify as efficiencies that are cognizable and verifiable.[186]

5.4 The Methodology and Welfare Standard Employed

The welfare standard that the US employs becomes clear in the Merger Guidelines' emphasis on consumers. Specifically, the 1997 Guidelines state that:

> "The Agency will not challenge a merger if cognizable efficiencies are of a character and magnitude such that the merger is not likely to be anticompetitive in any relevant market. To make the requisite determination, the Agency considers *whether cognizable efficiencies likely would be sufficient to reverse the merger's potential to harm consumers* in the relevant market, e.g., by preventing price increases in that market. In conducting this analysis, the Agency will not simply compare the magnitude of the cognizable efficiencies with the

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[185] Federal Trade Commission, *Anticipating the 21st Century: Competition Policy in the New High-Tech, Global Marketplace: A Report by the Federal Trade Commission Staff* (1966). The report suggested that efficiencies should "constitute a rebuttal [to a market-share-based prima facie case], not an affirmative defense." (Ch. 2 at 25)

[186] Horizontal Merger Guidelines 1997, Department of Justice and the Federal Trade Commission, section 4.

> magnitude of the likely harm to competition absent the efficiencies. The greater the potential adverse competitive effect of a merger... the greater must be cognizable efficiencies in order for the Agency to conclude that the merger will not have an anticompetitive effect in the market."[187] (emphasis added)

"Cognizable efficiencies" are explained to be "(1) merger specific efficiencies that (2) have been verified and (3) do not arise from anticompetitive reductions in output or service." The Guidelines went on to explain that efficiencies are unlikely to matter when the lessening of competition is great:

> "In the Agency's experience, efficiencies are most likely to make a difference in merger analysis when the likely adverse competitive effects, absent the efficiencies, are not great. *Efficiencies almost never justify a merger to monopoly or near-monopoly.* (emphasis added).[188]

From the above, it is clear the Guidelines adopt a *price* or *consumer surplus* standard. In a recent speech, Assistant Attorney General Charles A. James[189] indicated that it is his (and the EU Commission's) "view that the ultimate goal of antitrust policy must be consumer welfare..."

It is important to point out, however, that the Guidelines did open the door to consideration of efficiencies in situations that might not have been acceptable previously. First, they indicate that the agencies may consider efficiencies that will return benefits to consumers only in the future: "The Agency will consider the effects of cognizable efficiencies with no short-term, direct effect on prices in the relevant markets." Kolasky and Dick (2002, pp. 31-32) are of the view that this makes the welfare standard for tradeoffs between efficiencies and anticompetitive effects "more of a hybrid consumer/total welfare model".

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[187] Horizontal Merger Guidelines 1997, Department of Justice and the Federal Trade Commission, section 4.

[188] This part of the Guidelines was referred to by the D.C. District Court of Appeals decision in the Heinz case when it argued that very high levels of concentration required, on rebuttal, "proof of extraordinary efficiencies". FTC v. Heinz Co. 346 F. 3d 708 (D.C. Cir. 2001) at 720.

[189] Presented at the Program on Antitrust Policy in the 21st Century. Sponsored by the Directorate General for Competition at the European Commission and the U.S. Mission to the European Union, Brussels, Belgium, May 15, 2002.

Second, an important footnote in the Guidelines addresses the question of how the agencies would deal with a merger that has efficiencies in one market but net anticompetitive effects in another. This is an interesting question because it goes to the agency's willingness to accept harm to some consumers as long as this harm is balanced by gains to other consumers. While the agencies say that they would normally challenge such a merger, they might accept it if the efficiencies are "inextricably linked" to the anticompetitive harm and if the imbalance is substantial (i.e. the efficiencies are great and the anticompetitive effects small).[190]

5.5 Efficiencies and Consumers' Welfare

It appears that efficiencies are not required to be passed on to consumers, but that consumer welfare must not be lessened. On these points the Supreme Court's precedents (*Brown Shoe Co, Procter & Gamble and Philadelphia National Bank*) on efficiency claims in mergers are not conclusive. Röller et al. (2000) states that the three cases, when read in their context seems to preclude an efficiency defense, but also that it must be kept in mind that an efficiency defense was never directly raised in court. Furthermore, Röller et al. concludes that 'the decisions are based in large part on the understanding of legislative history and formalistic rules rather than on economic theory.[191]

As a result of the confusion about the Supreme Court's position, the lower courts' treatment of efficiency claims are particularly relevant. Rowley and Baker (2001) suggest that lower courts have become increasing sensitive to efficiency arguments.[192]

In *University Health*[193], as discussed above, the District Court determined that a defendant may, in certain circumstances, rebut the government's prima facie case with evidence of efficiencies.

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[190] Footnote 36. On this, see also Kolasky and Dick (2002) p. 32.

[191] See also OCDE/GD(96)65 from the OECD, p. 41, and Röller et al. (2000), para. 5.1.3.1.

[192] The Court of Appeals in the Heinz case also noted, when discussing the possibility of an efficiency defense, that "the trend among lower courts is to recognize the defense." *FTC v. H. J. Heinz Co.* 246 F.3d 708 (D.C. Cir. 2002) at 720.

However, the court found that, in this case, the parties had "not presented sufficient evidence to support the claim that the intended merger would produce efficiencies benefiting consumers." The decision appears to take a positive view of efficiencies, if the parties can prove the benefits to consumers. The parties' claims had, according to the court, been 'speculative'.

In *FTC v. Tenet Health Care Corp.*, the Court of Appeal reversed a preliminary injunction blocking a merger, in part because it believed that the district court had committed an error by refusing to consider "evidence of enhanced efficiency in the context of the competitive effects of a merger".[194]

In *U.S. v. Long Island Jewish Medical Center*[195], the court found that efficiencies were significant and that they would ultimately benefit consumers. The cost savings amounted to $25-30 million a year. The court's reasoning for finding in favor of the merging parties rebuttal of the prima facie case, was the fact the hospitals were not-for-profit, and would therefore likely pass on cost savings to consumers. Also, the parties had entered into an agreement with the New York Attorney General stating that they would pass on to the community any substantial cost savings that would be achieved.[196] The Government had in this case argued that the merger would be to monopoly, but the court found the definition of relevant market too narrow.[197]

At least one district court has recognized that efficiencies can make for a more successful competitor and this might ultimately benefit consumers. In *U.S. v. Country Lakes Foods, Inc.*, the District Court found that the merger would enable the merged firm "to compete directly with the market leader" and thereby "enhance competition".[198]

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[193] *FTC v. University Health, Inc.* 938 F.2d 1206 (11th Cir. 1991) at 1223.

[194] 186 F. 3d 1045 (8th Cir. 1999) at 1054.

[195] *U.S. v. Long Island Jewish Medical Center*, 938 F. Supp. 121 (E.D.N.Y 1997)

[196] Röller et al. (2000), p. 77.

[197] See, e.g., Muris (1999) for an analysis of this case.

[198] 754 F. Supp. 669 (D. Minn. 1990) at 680. Kolasky and Dick (2002) at pp. 38-39 claim that this is "the only litigated non-hospital case in which an efficiencies defense has prevailed."

5.6 Merger Specificity and Attainability in a less anti-competitive Manner

In one of the more subtle changes between the 1992 and 1997 Merger Guidelines, the new guidelines determined that merger-specific efficiencies were "efficiencies likely to be accomplished with the proposed merger and unlikely to be accomplished in the absence of either the proposed merger or another means having comparable anticompetitive effects." While the previous guidelines had required that the efficiencies could not be achieved in less anticompetitive ways, the 1997 revisions required only that they would not likely be achieved in a less anticompetitive way.

In *Heinz*[199] the appeal court concluded that the district court (which had denied an FTC request for an injunction against the merger) had erroneously failed to explain why the parties could not achieve comparable efficiencies absent the merger. This was a merger between two of only three producers of baby food in a market where market entry was considered unlikely. The court also indicated that the very high concentration levels required 'proof of extraordinary efficiencies'.[200]

Courts have found cases in which efficiencies could be achieved in a less anticompetitive manner and therefore rejected efficiency claims made in support of a merger. In *Staples*[201] the court held that the merging parties were expanding rapidly, and did not need to merge in order to benefit from claimed efficiencies related to buyer power. The merger involved the two largest office supply 'superstores', and would have resulted in a monopoly situation in some markets, and duopolies in others.

In *Ivaco* (a joint venture)[202] the court commented that the parties had not seriously considered less anticompetitive alternatives, nor explained why the alternatives were impractical or unattractive. The case concerned a full joint venture between the two leading manufacturers of automatic railroad tampers.

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[199] *FTC v. H. J. Heinz Co.* 246 F.3d 708 (D.C. Cir. 2001).

[200] See Kolasky and Dick (2002).

[201] *FTC v. Staples, Inc.* 970 F. Supp. 1066 (D.D.C 1997).

[202] United States v. Ivaco, Inc., 704 F. Supp. 1409, 1420 (W.D. Mich. 1989). See OCDE/GD(96)65 from the OECD, footnote 19.

5.7 Efficiencies and Other Competitive Restraints

Efficiency considerations now play an important role in the analysis of horizontal agreements in the U.S. The review process for these agreements is spelled out in the FTC – DOJ Antitrust Guidelines for Collaborations between Competitors, issued in April 2000. At the outset, the existence of efficiencies determine whether or not the agreement will be assessed under the strict *per se* rule, or under the more flexible *rule of reason.* If no efficiencies or benefits to the consumer can be found, and competition is harmed, the agreement will be challenged as per se illegal. Such agreements include price fixing, bid rigging and sharing of markets. On the other hand, if at the outset it appears that the agreement brings about benefits (i.e. efficiencies) that might be pro-competitive, all aspects of the agreement are more carefully considered. Such agreements can include collaboration on research and development, and joint-production agreements, which can realize economies of scale or scope. The benefits to consumers arising from such agreements can include a reduction of prices, expanding output, enhanced quality or service, and greater innovation.[203]

In order for efficiency claims to be considered they must be verifiable, potentially procompetitive, reasonably necessary and not attainable by less restrictive alternatives. Although the agencies (DOJ and FTC) recognizes the difficulty in verifying and quantifying efficiencies, the parties must describe:

> "how and when each would be achieved; any costs of doing so; how each would enhance the collaboration's or its participants' ability and incentive to compete; and why the relevant agreement is reasonably necessary to achieve the claimed efficiencies. Efficiency claims are not considered if they are vague or speculative or otherwise cannot be verified by reasonable means."[204]

If the parties have fulfilled these requirements, the agencies will consider whether the efficiencies would be sufficient to offset the potential harm to consumers in the relevant market.

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[203] Antitrust Guidelines for Collaborations Among Competitors, DOJ and FTC, April, 2000, chapter 2.

[204] Antitrust Guidelines for Collaborations Among Competitors, DOJ and FTC, April, 2000, para. 3.36.

The more delayed the benefits of the efficiencies are in reaching the consumers, the less weight will they be given. As the anticompetitive effects of the agreement increases, the parties must establish a greater level of efficiencies.

Similarly, as discussed above, as a result of decisions like that in *GTE Sylvania*, the enforcement agencies and courts have become much more sympathetic to efficiency arguments in cases involving potentially anticompetitive vertical agreements.

It is probably fair to say, however, that the agencies and courts do not use efficiencies to balance off against anticompetitive effects in any sort of total surplus calculation. In each case it would seem the focus is very much on whether the agreement or restriction ultimately provides benefits to consumers.

5.8 NAAG Guidelines

As mentioned above, state attorneys-general will, in some cases, become involved in antitrust matters. In part as a reaction to the perceived lower levels of federal antitrust enforcement in the Reagan administration, the National Association of Attorneys-General (NAAG) issued its own guidelines.[205] In general, the NAAG Guidelines are tougher on mergers, presuming anticompetitive effects in cases in which the FTC and DOJ would not. Significantly, these guidelines appear somewhat less sympathetic to efficiencies. The NAAG Guidelines explicitly reject efficiencies as a defense to an otherwise unlawful merger and they will not consider efficiencies if the market is highly concentrated (which may be a lower standard than monopoly or near monopoly).

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[205] National Association of Attorneys-General, Horizontal Merger Guidelines, issued March 30, 1993, 4 Trade Reg. Rep. (CCH) ¶13,406 . NAAG is not itself an enforcement agency and individual states may choose whether or not to follow its guidelines.

6 Concluding Thoughts

Our survey of these four jurisdictions has revealed some commonality but many differences in their approaches toward the incorporation of efficiencies into merger review. The one important and strikingly common feature is change – all four jurisdictions have either recently issued new guidelines with respect to efficiencies (U.S.), are formally planning for revisions (U.K.) or are in the throws of a debate about making revisions to their approaches (Australia and the EU). It would seem that all are struggling in particular with the question of how to weigh efficiencies against a lessening of competition.

It is also true of all four regimes that efficiencies matter – and matter positively in general. That is, there is a place for efficiency arguments to be made that could persuade any of these agencies to permit a merger that might have some potential for anticompetitive harm. The scope for these efficiency arguments varies considerably, however. We return to this shortly.

Other similarities come in pairs, and we offer three examples. First, both the U.S. and Australia apply a substantial lessening of competition (SLC) test to determine whether mergers should be enjoined. In contrast, the EU applies a dominance test (as Australia did previously) and the U.K. a public interest test. As the EU embraces joint dominance as a legitimate concern, however, its standard will come closer to the SLC test. Second, both the U.S. and the EU have in the past had experiences in which efficiencies apparently weighed against a merger out of a fear that the efficiencies would make it difficult for other firms to compete. Significantly, the U.S. has quite clearly retreated from this view and the EU would appear to be trying to distance itself as well. Third, both Australia and the U.K. employ a public interest or benefits standard for at least some of their merger reviews. In neither case does the legislation spell out precisely what is meant by "public interest" or "public benefit", giving the authorities potentially great scope for action (or reason for non-action). That said, both jurisdictions would appear to be heading toward a treatment of public benefits/interests as very close to the promotion of competition and efficiency. Other considerations, such as employment or increasing exports seem to be waning in importance.

As mentioned, the scope for using efficiencies to support a possibly anticompetitive merger varies across these jurisdictions. While the EU has probably been the least sympathetic to efficiency arguments when they have been raised in the past, it should be noted that its dominance test is probably less restrictive of mergers generally than the American SLC standard.[206] In a sense it could be said that they have incorporated efficiencies, at least to some extent, by raising the thresholds for merger review. The EU *Merger Regulation* also directs the European Commission to consider "the development of technical and economic progress, provided that it is to consumers' advantage and does not form an obstacle to competition" (Article 2(1)(b)). This commands the Commission to give at least some consideration to efficiencies as long as consumers benefit. Similarly, the U.S. Guidelines clearly demonstrate a willingness to consider efficiencies as part of the determination of whether there has been an SLC. Again, however, consumers will have to benefit (or at least not be hurt) before they can rescue a merger that increases market power.

In principle, the jurisdictions which could give the greatest respect to efficiencies would be Australia and the U.K. through their public interest/benefits tests. However, even as their "public benefits/interests" seem to be have become more focused on competition and efficiency, it is difficult to say how generous these two countries will be toward efficiencies when competition is lessened. In Australia, at least, there is a recognition that public benefits can outweigh the detriment to the public due to a lessening of competition.

None of these jurisdictions has an explicit efficiency defense built into its antitrust policy the way Canada does. Furthermore, none of them apply a total surplus standard. That said, and to return to a previous theme, the treatment of efficiencies continues to evolve in all of these jurisdictions and the trend is toward a greater role for efficiencies. For example, as discussed above, the 1997 American merger guidelines contemplate tolerating harm to some consumers as long as other consumers benefit more. Similarly, the Australian authorities seem willing to

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[206] To put this another way: any merger in the U.S. that involved concentration levels and other conditions such that (under European standards) there would be a dominance situation would likely not be one in which efficiency arguments were any more warmly received than they would be in the EU

permit the loss of some consumer surplus if public benefits (which may be largely efficiencies) are great enough.

Clearly, the incorporation of efficiencies in merger review is an area of competition policy posing difficult questions with which many jurisdictions continue to struggle. We will be watching developments with a keen interest.

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8 Appendix A – Relevant Australian Merger Provisions

TRADE PRACTICES ACT 1974

Section 50 (1)-(3)

(1) A corporation must not directly or indirectly:

(a) acquire shares in the capital of a body corporate; or
(b) acquire any assets of a person;
if the acquisition would have the effect, or be likely to have the effect, of substantially lessening competition in a market.

(2) A person must not directly or indirectly:
(a) acquire shares in the capital of a corporation; or
(b) acquire any assets of a corporation;
if the acquisition would have the effect, or be likely to have the effect, of substantially lessening competition in a market.

(3) Without limiting the matters that may be taken into account for the purposes of subsections (1) and (2) in determining whether the acquisition would have the effect, or be likely to have the effect, of substantially lessening competition in a market, the following matters must be taken into account:

(a) the actual and potential level of import competition in the market;

(b) the height if barriers to entry to the market;

(c) the level of concentration in the market;

(d) the degree of countervailing power in the market;

(e) the likelihood that the acquisition would result in the acquirer being able to significantly and sustainably increase prices or profit margins;

(f) the extent to which substitutes are available in the market or are likely to be available in the market;

(g) the dynamic characteristics of the market, including growth, innovation and product differentiation;

(h) the likelihood that the acquisition would result in the removal from the market of a vigorous and effective competitor;

(i) the nature and extent of vertical integration in the market.

Section 50A(1)

(1) Where a person acquires, outside Australia, otherwise than by reason of the application of paragraph (8)(b), a controlling interest (the 'first controlling interest') in any body corporate and, by reason, but not necessarily by reason only, of the application of paragraph (8)(b) in relation to the first controlling, obtains a controlling interest ('the second controlling interest') in a corporation or each of two or more corporations, the Tribunal may, on the application of the Minister, the Commission or any other person, if the Tribunal is satisfied that –

(a) the person's obtaining of the second controlling interest would have the effect, or be likely to have the effect, of substantially lessening competition in a market; and

(b) the person's obtaining of the second controlling interest would not, in all the circumstances, result, or be likely to result, in such a benefit to the public that the obtaining should be disregarded for the purposes of this section, make a declaration accordingly.

Section 88

(9) Subject to this Part, the Commission may, upon application by or on behalf of a person:

(a) grant an authorisation to the person to acquire shares in the capital of a body corporate or to acquire assets of a person; or

(b) grant an authorisation to the person to acquire a controlling interest in a body corporate within the meaning of section 50A;

and, while such and authorisation remains in force:

(c) in the case of an authorisation under paragraph (a) – section 50 does not prevent the person from acquiring shares or assets in accordance with the authorisation; or

(d) in the case of an authorisation under paragraph (b) – section 50A does not, to the extent specified in the authorisation, apply in relation to the acquisition of that controlling interest.

Section 90

(9) The Commission shall not make a determination granting an authorisation under subsection 88(9) in respect of a proposed acquisition of shares in the capital body corporate or of assets of a person or in respect of the acquisition of a controlling interest in a body corporate within the meaning of section 50A unless it is satisfied in all the circumstances that the proposed acquisition would result, or be likely to result, in such a benefit to the public that the acquisition should be allowed to take place.

(9A) In determining what amounts to a benefit to the public for the purposes of subsection (9):

(a) the Commission must regard the following as benefits to the public (in addition to any other benefits to the public that may exist apart from this paragraph):

(i) a significant increase in the real value of exports;

(ii) a significant substitution of domestic products for imported good; and

(b) without limiting the matters that may be taken into account, the Commission must take into account all other relevant matter that relate to the international competitiveness of any Australian industry.

9 Appendix B -- Relevant EU Merger Provisions

Merger Regulation 1989

Article 2

Appraisal of concentrations

1. Concentrations within the scope of this Regulation shall be appraised in accordance with the following provisions with a view to establishing whether or not they are compatible with the common market. In making this appraisal, the Commission shall take into account:

(a) the need to maintain and develop effective competition within the common market in view of, among other things, the structure of all the markets concerned and the actual or potential competition from undertakings located either within or outwith the Community;
(b) the market position of the undertakings concerned and their economic and financial power, the alternatives available to suppliers and users, their access to supplies or markets, any legal or other barriers to entry, supply and demand trends for the relevant goods and services, the interests of the intermediate and ultimate consumers, and the development of technical and economic progress provided that it is to consumers' advantage and does not form an obstacle to competition.

2. A concentration which does not create or strengthen a dominant position as a result of which effective competition would be significantly impeded in the common market or in a substantial part of it shall be declared compatible with the common market.

3. A concentration which creates or strengthens a dominant position as a result of which effective competition would be significantly impeded in the common market or in a substantial part of it shall be declared incompatible with the common market.

EC Treaty

Art. 81

1. The following shall be prohibited as incompatible with the common market: all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the common market, and in particular those which:
   (a) directly or indirectly fix purchase or selling prices or any other trading conditions;
   (b) limit or control production, markets, technical development, or investment;
   (c) share markets or sources of supply;
   (d) apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them in a competitive disadvantage;

(e) make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

2. Any agreements or decisions prohibited pursuant to this Article shall be automatically void.
3. The provisions of paragraph 1 may, however, be declared inapplicable in the case of:
   - any agreement or category of agreements between undertakings;
   - any decision or category of decisions by associations of undertakings;
   - any concerted practice or category of concerted practices,

   which contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, and which does not:

   (a) impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives;

   (b) afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question.

Art. 82

Any abuse by one or more undertakings of a dominant position within the common market or in a substantial part of it shall be prohibited as imcompatible with the common market insofar as it may affect trade between Member States.

Such abuse may, in particular, consist in:

(a) directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions;

(b) limiting production, markets or technical development to the prejudice of consumers;

(c) applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;

(d) making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

10 Appendix C – Relevant UK Merger Provisions

Relevant provisions of the UK Fair Trading Act 1973

S. 64 Fair Trading Act

A merger situation qualifying for investigation is taken to occur if:

(a) two or more enterprises cease to be distinct enterprises, or there are arrangements in progress which will lead to enterprises ceasing to be distinct;

(b) at least one of which was carried on in the United Kingdom or under the control of a body corporate incorporated in the United Kingdom;

(c) Either the merger has not yet taken place or it has taken place not more than four months before the reference is made, unless it took place without public notice and without the Secretary of State or the Director-General being told about it (in which case the four-month period starts from the announcement or the time the Secretary of State or the Director-General is told); and

(d) Either:

- Those enterprises would together supply or receive at least one-quarter of the goods or services of a particular description supplied in the United Kingdom or a substantial part of it; or,
- The value of the assets taken over exceeds £70 million.

S. 65 Fair Trading Act

Enterprises are taken to cease to be distinct enterprises if either:

(a) they are brought under common ownership or common control – whether or not the business to which either of them formerly belonged continues to be carried on under the same or different ownership or control – or,

(b) either of the enterprises ceases to be carried on at all and does so in consequence of an arrangements or transaction entered into to prevent competition between the enterprises.

Enterprises are taken to be under 'common control' if they are:

(a) enterprises of interconnected bodies corporate; or,

(b) enterprises carried on by two or more bodies corporate of which one and the same person or group of persons has control; or,

(c) an enterprise carried on by a body corporate and an enterprise carried on by a person or group of persons having control of that body corporate.

A person is regarded as 'having control' of an enterprise if he is able directly or indirectly materially to influence the policy of that enterprise, although not having a controlling interest in it.

S. 73 Fair Trading Act

If as a result of a reference to the Monopolies and Mergers Commission, a merger situation qualifying for investigation is found to exist and it is found that it operates or may be expected to operate against the public interest the Secretary of State is empowered to take action to remedy or prevent any adverse effects specified in the Commission's report.

S. 84 Fair Trading Act

In determining whether any particular matter operates, or may be expected to operate, against public interest, the Commission shall take into account all matters which appear to them in the particular circumstances to be relevant and, among other things, shall have regard to the desirability

(a) Of maintaining and promoting effective competition between persons supplying goods and services in the United Kingdom;
(b) Of promoting the interests of consumers, purchasers and other users of goods and services in the United Kingdom in respect of the prices charged for them and in respect of their quality and the variety of goods and services supplied;
(c) Of promoting, through competition, the reduction of costs and the development and use of new techniques and new products, and of facilitating the entry of new competitors into existing markets;
(d) Of maintaining and promoting the balanced distribution of industry and employment in the United Kingdom; and
(e) Of maintaining and promoting competitive activity in markets outside the United Kingdom on the part of producers of goods and of suppliers of goods and services, in the United Kingdom.

11 Appendix D – Relevant US Merger Provisions

Relevant provisions of the Clayton Act (15 U.S.C. § 18)

Section 7

No person engaged in commerce or in any activity affecting commerce shall acquire, directly or indirectly, the whole or any part of the stock or other share capital and no person subject to the jurisdiction of the Federal Trade Commission shall acquire the whole or any part of the assets of another person engaged also in commerce or in any activity affecting commerce, where in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly.

No person shall acquire, directly or indirectly, the whole or any part of the stock or other share capital and no person subject to the jurisdiction of the Federal Trade Commission shall acquire the whole or any part of the assets of one or more persons engaged in commerce or in any activity affecting commerce, where in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition, of such stocks or assets, or of the use of such stock by the voting or granting of proxies or otherwise, may be substantially to lessen competition, or to tend to create a monopoly.

This section shall not apply to persons purchasing such stock solely for investment and not using the same by voting or otherwise to bring about, or in attempting to bring about, the substantial lessening of competition. Nor shall anything contained in this section prevent a corporation engaged in commerce or in any activity affecting commerce from causing the formation of subsidiary corporations for the actual carrying on of their immediate lawful business, or the natural and legitimate branches or extensions thereof, or from owning and holding all or a part of the stock of such subsidiary corporations, when the effect of such formation is not to substantially lessen competition.

Nor shall anything herein contained be construed to prohibit any common carrier subject to the laws to regulate commerce from aiding in the construction of branches or short lines so located as to become feeders to the main line of the company so aiding in such construction or from acquiring or owning all or any part of the stock of such branch lines, nor to prevent any such common carrier from acquiring and owning all or any part of the stock of a branch or short line constructed by an independent company where there is no substantial competition between the company owning the branch line so constructed and the company owning the main line acquiring the property or an interest therein, nor to prevent such common carrier from extending any of its lines through the medium of the acquisition of stock or otherwise of any other common carrier where there is no substantial competition between the company extending its lines and the company whose stock, property, or an interest therein is so acquired.

Nothing contained in this section shall be held to affect or impair any tight heretofore legally acquired: Provided, That nothing in this section shall be held or construed to authorize or make

lawful anything heretofore prohibited or make illegal by the antitrust laws, nor to exempt any person from the penal provisions thereof or the civil remedies therein provided.

Nothing contained in this section shall apply to transactions duly consummated pursuant to authority given by the Secretary of Transportation, Federal Communications Commission, Federal Power Commission, Interstate Commerce Commission, the Securities and Exchange Commission in the exercise of its jurisdiction under section 79j of this title, the United States Maritime Commission, or the Secretary of Agriculture under any statutory provision vesting such power in such Commission or Secretary.